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No.

In the Supreme Court

OF THE

United States

October Term, 1984

People of the State of California and
Public Utilities Commission of the
State of California, et al.,
Petitioners,

vs.

Federal Communications Commission and
United States of America,
Respondents.

APPENDIX TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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Appendix A

United States Court of Appeals for the Fourth Circuit

No. 83-1136

[Filed June 18, 1984]

Virginia State Corporation Commission,	Petitioner,
v.	
Federal Communications Commission and United States of America,	Respondent.
North American Telephone Association,	Intervenor./R,
American Telephone and Telegraph Company,	Intervenor./R,
Florida Public Service Commission,	Intervenor./P,
State of Michigan and Michigan Public Service Commission,	Intervenor./P,
Department of Public Utility Control of the State of Connecticut,	Intervenor./P,
People of the State of California and the Public Utilities Commission of the State of California,	Intervenor./P,
National Association of Regulatory Utility Commissioners,	Intervenor./P,
Southern Pacific Communications Company,	Intervenor./R,
Public Service Commission of the District of Columbia,	Intervenor./P,
Public Utilities Commission of Ohio,	Intervenor./P,
Arkansas Public Service Commission,	Intervenor./P,
Kansas State Corporation Commission,	Intervenor./P,
GTE Service Corporation,	Intervenor./R,
Public Service Commission of Wyoming,	Intervenor./P,
Continental Telecom Inc.,	Intervenor./R,
Washington Utilities and Transportation Commission,	Intervenor./P,
United Telephone System, Inc.,	Intervenor./R,
Department of Public Service of the State of Minnesota,	Intervenor./P,
Arizona Corporation Commission,	Intervenor./P,
Cincinnati Bell Inc.,	Intervenor./R,
Citizens of the State of Florida,	Intervenor./P,

National Association of State Utility Consumer Advocates,	Intervenor./P,
Consumer Advocate of South Carolina,	Intervenor./P,
Office of Consumers' Counsel for the State of Ohio,	Intervenor./P,
Iowa State Commerce Commission,	Intervenor./P,
Public Service Commission of Wisconsin,	Intervenor./P,
Public Service Commission of West Virginia,	Intervenor./P,
New York State Department of Public Service,	Intervenor./P,
The Bell Telephone Company of Pennsylvania,	Intervenor./R,
The Chesapeake and Potomac Telephone Company,	Intervenor./R,
The Chesapeake and Potomac Telephone Company of Maryland,	Intervenor./R,
The Chesapeake and Potomac Telephone Company of Virginia,	Intervenor./R,
The Chesapeake and Potomac Telephone Company of West Virginia,	Intervenor./R,
The Diamond State Telephone Company,	Intervenor./R,
Illinois Bell Telephone Company,	Intervenor./R,
Indiana Bell Telephone Company, Incorporated,	Intervenor./R,
Michigan Bell Telephone Company,	Intervenor./R,
The Mountain States Telephone and Telegraph Company,	Intervenor./R,
New England Telephone and Telegraph Company,	Intervenor./R,
New Jersey Bell Telephone Company,	Intervenor./R,
New York Telephone Company,	Intervenor./R,
Northwestern Bell Telephone Company,	Intervenor./R,
The Ohio Bell Telephone Company,	Intervenor./R,
Pacific Northwest Bell Telephone Company,	Intervenor./R,
The Pacific Telephone and Telegraph Company,	Intervenor./R,
Bell Telephone Company of Nevada,	Intervenor./R,
South Central Bell Telephone Company,	Intervenor./R,
Southern Bell Telephone and Telegraph Company,	Intervenor./R,
The Southern New England Telephone Company,	Intervenor./R,
Southwestern Bell Telephone Company,	Intervenor./R,
Wisconsin Telephone Company,	Intervenor./R,
Board of Public Utilities of New Jersey,	Intervenor./R,
Louisiana Public Service Commission,	Intervenor./R.

On Petition for Review from a Decision by the Federal Communications Commission.

Argued October 7, 1983 Decided June 18, 1984

Before Widener, Murnaghan, and Sprouse, Circuit Judges.

Russell W. Cunningham (Donald G. Owens, Sherry H. Bridewell; David E. Blabey, Lawrence G. Malone; Lynwood J. Evans; Richard P. Rosenberry, Lawrence F. Barth; Lloyd N. Moore, Jr.; Donald A. Low, Rosemary O'Leary; Harris S. Leven, Jonathan L. Heller; Jean E. Heilman; Lee McCulloch; Jack Shreve, Benjamin H. Dickens, Jr.; Steven W. Hamm, Raymond E. Lark, Jr., Russell H. Putman, Jr.; Joseph I. Lieberman, Peter J. Jenkelunas; Janice E. Kerr, Gretchen Dumas, J. Calvin Simpson; Douglas N. Owens; Steven R. Shanahan; Bruce W. Renard; Diane L. McIntire; Steven M. Schur, Jon E. Kingstad; Paul Rodgers, Charles D. Gray; Frank J. Kelly, John M. Dempsey; Joel B. Shifman on brief) for Petitioner; John E. Ingle, Deputy Associate General Counsel (Bruce E. Fein, General Counsel, Daniel M. Armstrong, Associate General Counsel on brief) for Respondents; Michael Boudin (Leonard R. Stein; Raymond F. Scully, Lester G. Stiel, W. Preston Granbery; Earl R. Huffman, David Horn; Thomas L. Jones, John Wohlstetter; Richard McKenna, James Hobson; Albert H. Kramer; John W. Hunter, Carolyn C. Hill; Maria A. Kendro on brief) for Intervenors Supporting Respondents.

Murnaghan, Circuit Judge:

The controversy here presented involves an order of the Federal Communications Commission (FCC) entitled "Uniform System of Accounts and Petition for Declaratory Ruling on Question of Federal Preemption." CC Docket No. 79-105, FCC 82-581 (released Jan. 6, 1983). The order provides that, when the FCC has prescribed depreciation rates and methods for classes of property used by telephone companies, state regulation of the same matter is thereby preempted.

Petitioner, Virginia State Corporation Commission, along with multiple Petitioner-Intervenors representing

regulatory agencies of other states, argues that the states' fixing of depreciation rates and accounting methods for intrastate ratemaking purposes is preempted neither by the express language of the Federal Communications Act of 1934, 47 U.S.C. § 151 *et seq.* (1976) (the Act), nor by FCC rules explicitly governing depreciation of telephone equipment and facilities that are used interchangeably to provide both interstate and intrastate service. We agree with the FCC that its order released January 6, 1983 preempts state regulation of the depreciation rates and methods here involved, and thereby reemphasize our recognition in *North Carolina Utilities Commission v. F.C.C.*, 552 F.2d 1036 (4th Cir. 1977) ("NCUC II"), *cert. denied*, 434 U.S. 874 (1977), that "FCC regulations must preempt any contrary state regulations where the efficiency . . . of the national communications network is at stake. . . ." *Id.* at 1046.

I. Background

Under the current state of the telecommunications art, local telephone companies provide "telephone plant" (facilities and equipment) that serve both interstate and intrastate communications needs. Section 152 of the Act provides in subsection (a) that the statute "shall apply to all interstate and foreign communication by wire," but in subsection (b) that "nothing in this chapter shall be construed to apply or to give the Commission jurisdiction with respect to (1) charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service by wire . . . ." Within this framework of divided authority, the Commission's statutory mandate is a broad one, "to make available . . . to all the people of the United States a rapid, efficient, Nationwide, and worldwide wire . . . communication service with adequate facilities at reasonable charges. . . ." 47 U.S.C. § 151.

In order to achieve the mandated goal, the FCC is specifically empowered under 47 U.S.C. § 220 to prescribe depreciation practices to be followed by interstate carriers.[1] At the same time, the Act recognizes the continued vitality of state regulation of intrastate service. Section 221(b) provides that "nothing in this chapter shall be construed to apply, or to give the Commission jurisdiction, with respect to charges, classifications, practices, services, facilities, or regulations for or in connection with wire . . . exchange service . . . even though a portion of such exchange service constitutes interstate . . . communication, in any case where such matters are subject to regulation by a State commission or by local governmental authority." Because most of the nation's telephone plant is used interchangeably to serve both interstate and intrastate telecommunications needs,

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[1]Section 220(b) provides that:

The Commission shall, as soon as practicable, prescribe for such carriers the classes of property for which depreciation charges may be properly included under operating expenses, and the percentages of depreciation which shall be charged with respect to each of such classes of property . . . . The Commission may, when it deems necessary, modify the classes and percentages so prescribed. Such carriers shall not, after the Commission has prescribed the classes of property for which depreciation charges may be included, charge to operating expenses any depreciation charges on classes of property other than those prescribed by the Commission, or after the Commission has prescribed percentages of depreciation, charge with respect to any class of property a percentage of depreciation other than that prescribed therefor by the Commission. . . .

(g) After the Commission has prescribed the forms and manner of keeping of accounts . . . it shall be unlawful for [the carrier] to keep any other accounts . . . than those so prescribed . . . or to keep accounts in any manner other than that prescribed or approved by the Commission. . . .

the potential for conflict between federal and state regulatory action is obvious.[2]

The conflict at issue on this appeal had its genesis in two separate orders issued by the FCC in 1980 and 1981; both orders were designed to compel carriers to employ depreciation practices that more truly reflected actual depreciation rates in light of technological reality. After seven years of study, the FCC first determined in 1980 that the prior practice of "vintage year" grouping for depreciation purposes was inaccurate, and ordered that the "equal life group" method be used. *See* Docket No. 20188, 83 F.C.C.2d 267 (1980). The equal life method permitted greater precision in allocating costs of service to current consumers, and allowed more rapid capital recovery for plant having a short useful life.[3]

Thus, while the prior "vintage year" method was thought to "stifle innovation and inhibit the introduction of new technology," 83 F.C.C.2d at 281, the "equal life" method was intended to bolster the competitive market structure that the FCC sought to foster. The same 1980 order also replaced the "whole life" method of depreciation with the

[2]This Court has already recognized that tandem use of telephone plant to serve both interstate and intrastate needs is quite common. *See North Carolina Utilities Commission v. F.C.C.*, 537 F.2d 787, 794 (4th Cir. 1976) ("NCUC I"), *cert. denied*, 429 U.S. 1027 (1976) (*quoting Katz v. A.T.&T.*, 43 F.C.C. 1328, 1332 (1953)), to the effect that, "[w]ere the Commission to exercise its jurisdiction only where the telephone facilities in question were exclusively interstate in character, it would result in virtually complete abdication from the field of telephone regulation. . . ."

[3]For example, under the "vintage year" method, all types of telephone cable installed during one year (regardless of variations in useful lives of the cables) would be classed together and depreciated over the average useful life of the group. By contrast, the "equal life" method broke plant into smaller subgroups (*e.g.*, indoor cable as opposed to underground cable) that were depreciated separately, more in keeping with the plant's actual useful life.

"remaining life" method, which allowed a carrier to recoup the full cost of plant by making corrections in useful life estimates over time. 83 F.C.C.2d at 288-90.[4]

The FCC's 1981 order provided that inside wiring in homes and businesses no longer should be treated as a capital investment to be depreciated over time, but rather as a cost to be "expensed" to current users. Again, the thrust of the rule change was to ensure that consumers actually requesting and benefitting from installed wiring pay for that benefit. By expensing the wiring, the burden of costs associated with such station connections would be placed on the causative ratepayer, and other consumers would not be forced to bear rates unduly inflated by a depreciation component for wiring services previously provided. 85 F.C.C.2d 818, 824 (1981).

The two orders were first challenged on April 30, 1981, when the National Association of Regulatory Utility Commissioners ("NARUC") filed a Petition for Clarification of the 1981 wiring order. Specifically, NARUC requested that the FCC issue a statement that the provisions of the wiring order were not binding upon state regulatory commissions insofar as intrastate communications service was concerned. The FCC responded to the petition in a Memorandum Opinion and Order of April 27, 1982, in which it concluded that in light of the relevant legislative history of the Act, "where state [accounting and depreciation] regulation is reconcilable with federal policies or rules, there is no occasion for us to override state agency actions in furtherance

[4]Under the "whole life" method, underrecovery had become a common problem, since carriers were locked into inaccurate, overly long estimates of useful life in an industry in which innovation and resulting obsolescence were the order of the day. *See* 83 F.C.C.2d at 289-90.

of legitimate state regulatory objectives.'"[5] 89 F.C.C.2d 1094, 1108 (1982).

In response to the FCC's opinion and order, the American Telephone and Telegraph Company filed a Petition for Reconsideration on June 7, 1982. General Telephone Company of Ohio likewise petitioned for a Declaratory Ruling that inconsistent state action was foreclosed under the Act.[6] After further pleadings and comments, the FCC reversed its earlier position in a second Memorandum Opinion and Order of January 6, 1983. C.C. Docket No. 79-105, F.C.C. No. 82-581, slip op. (Jan. ...., 1983). After it carefully resurveyed the legislative history and decisional law, and reexamined the express language of the Act, the FCC adopted the view that the most logical and reasonable interpretation of the Act "is that where the Commission prescribes depreciation rates for classes of property [and the

[5]Writing for a 4-3 majority of the Commissioners, Secretary William J. Tricarico found that portions of the Act were geared "to achieve as much uniformity as possible without coercing any state commission to use ratemaking methods it found unacceptable." Tricarico also emphasized that the Commission had always given "special consideration to the needs and views of state commissions in developing accounting and depreciation rules and most State commissions have chosen to follow most accounting and depreciation rules prescribed by this Commission." 89 F.C.C.2d at 1106.

Commissioners Fogarty, Jones, and Rivera issued a Joint Dissenting Statement, in which they recognized the "clear preemptive thrust" of the wiring order and refused to defer to the states on a "critical capital recovery [issue] affecting the continued viability and competitiveness of our Nation's telephone industry in providing increasingly essential interstate, as well as intrastate, facilities and services." *Id.* at 1111.

[6]In its petition, General Telephone noted that the Ohio state regulatory agency had explicitly rejected use of the "remaining life" and "equal life group" methods adopted in the FCC's 1980 order. General Telephone therefore perceived a direct conflict between federal and state regulatory action, which would frustrate importation interests of national communications policy.

depreciation methods to be used], state commissions are precluded from departing" from those rates and methods. *Id.* at 17, ¶ 44. In reversing itself, the FCC espoused the notion that the plain terms of section 220 of the Act appear "clearly to preempt the states in connection with depreciation expense determinations and the related accounting." *Id.* at 6, ¶ 17. Moreover, the FCC found that, even if section 220 did not possess a preemptive effect as a matter of law, the FCC's own policies and rulings would preempt inconsistent state regulatory action as a matter of federal supremacy. *Id.* at 17, ¶ 45.

Supported by numerous state and local regulatory commissions, the Virginia State Corporation Commission ("VSCC") filed a Petition for Review of the January 6, 1983 Order. VSCC alleged that preemption was required neither as a matter of law nor as a result of regulatory action taken by the FCC.

Relying in part on this Court's prior decisions in *NCUC I* and *NCUC II*, and relevant decisions of other Circuits,[7] we hold that inconsistent state regulation of depreciation methods and classes of property to be depreciated has been preempted by the rulings of the FCC. Because we have determined that the affirmative regulatory action taken by the FCC suffices to preempt inconsistent state action, we find it unnecessary to decide whether, as a matter of law, the language of the Act itself requires preemption.

[7]*See Computer and Communications Industry Ass'n v. F.C.C.*, 693 F.2d 198 (D.C. Cir. 1982), *cert. denied*, ... U.S. ..., 103 S.Ct. 2109 (1983); *New York Telephone Co. v. F.C.C.*, 631 F.2d 1059 (2nd Cir. 1980); and *Puerto Rico Telephone Co. v. F.C.C.*, 553 F.2d 694 (1st Cir. 1977), discussed in text *infra*. *Contra Southwestern Bell Telephone Co. v. Arkansas Public Service Comm'n*, No. LR C 84 247, slip op. (Mar. 30, 1984) (Court holds that FCC lacked jurisdiction to issue the January 6, 1983 Order and refuses to enforce it as *ultra vires*).

II. Discussion

While it is true that the Act does reserve to the states the authority to prescribe rates for intrastate telephone service, that reservation is not to be read as preserving the states' sphere of intrastate jurisdiction at the expense of an efficient, viable interstate telecommunications network. Section 152(b) of the Act does make the broad pronouncement that "nothing in [the] chapter shall be construed . . . to give the Commission jurisdiction with respect to . . . intrastate communication service." Section 221(b) further supports state authority by providing that the FCC shall have no jurisdiction "even though a portion of [an] exchange service constitutes interstate or foreign communication, in any case where such matters are subject to regulation by a State commission or by local governmental authority."

Nonetheless, the foregoing provisions are rendered against a statutory backdrop that places *primary emphasis* upon a "rapid, efficient, Nationwide, and world-wide" communication service.[8] Given that overriding concern, the 1983 Opinion by the FCC construing the accounting and wiring orders of 1980 and 1981 is most reasonably interpreted as valid exercise of statutory authority by the FCC, preempting inconsistent state action by virtue of the Supremacy Clause.[9] While VSCC and Petitioner-Intervenors

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[8]47 U.S.C. § 151. *But see Southwestern Bell Telephone Co. v. Arkansas Public Service Comm'n,* No. LR C 84 247, slip op. at 3 (Mar. 30, 1984) (holding that FCC lacked jurisdiction to issue the January 6, 1983 Order, the Arkansas District Court refuses to permit FCC's mandate to provide efficient, nationwide service to "allow the FCC to bootstrap itself into preempting" intrastate rate-making determinations).

[9]"This Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding." U.S. Const. art. VI, cl. 2.

argue that "§ 221(b) has been given an unduly narrow interpretation in recent years,"[10] we do not view as "narrow" an interpretation which recognizes that the Act does not sanction a "state regulation, formally restrictive only of intrastate communication, that in effect encroaches substantially upon the Commission's authority" over interstate telecommunications. *NCUC I*, 537 F.2d at 793.

Such a finding comports well with the recent Supreme Court decision in *Fidelity Federal Savings & Loan Co. v. de la Cuesta,* 458 U.S. 141 (1982). The court stated in *de la Cuesta,* that "[e]ven where Congress has not completely displaced state regulation in a specific area, state law is nullified to the extent that it actually conflicts with federal law. Such a conflict arises when . . . state law 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Id.* at 153 (*quoting Hines v. Davidowitz,* 312 U.S. 52, 67 (1941)).[11] Although the

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[10]Referring explicitly to this Court's decision in *NCUC I,* counsel for VSCC requested at oral argument that we "revisit" the doctrine adopted in that case, which recognized that the FCC's authority to regulate had "primacy" over state regulatory action purporting to affect the interconnection of customer-provided telephone equipment. *See NCUC I,* 537 F.2d 788 (1976).

[11]Construing the Federal Alien Registration Act of 1940 in *Hines,* the Court recognized that there cannot be any "rigid formula or rule which can be used as a universal pattern" in determining Congress' intention to preempt. 312 U.S. at 67. The factual setting in which each case arises will thus shape the contours of a preemption determination.

See also Pacific Gas and Electric Co. v. State Energy Resources Conservation Development Commission, ... U.S. ...., 103 S. Ct. 1713 (1983), in which the Court again noted that preemption is proper when state law frustrates important federal goals. In *Pacific Gas,* the Court found that agency regulations issued pursuant to the Atomic Energy Act of 1954, 42 U.S.C. § 2011 *et seq.* (1976), did not preempt state authority to curtail the development of nuclear power for economic reasons. Because the Nuclear Regulatory Commission's regulations dealt with plant safety, while the

holding in *de la Cuesta* arose in the context of the Home Owner's Loan Act of 1938, 12 U.S.C. § 1461 *et seq.* (1982), the basic analysis applies to this appeal as well: an appellate court is not to focus narrowly on Congress' own intent specifically to supersede state regulation. Rather, the Court must determine whether the federal agency entrusted with administering the act meant to preempt, and whether such preemptive action is within the scope of the agency's authority. 458 U.S. at 154.[12]

First, it is quite clear that the FCC did intend to preempt inconsistent state regulation governing depreciation methods and classes of depreciable property. The 1983 Memorandum Opinion and Order stated in no uncertain terms that "we find that this Commission's depreciation policies and rates, including the expensing of inside wiring, preempt inconsistent state depreciation policies and rates." C.C. Docket No. 79-105, F.C.C. No. 82-581 (Jan. 6, 1983), slip op. at 17, ¶ 45.

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state regulations dealt with plant economy, compliance with both sets of regulations was possible without thwarting the federal objective. *Id.* at . . . .

[12]The Court explicitly stated in *de la Cuesta,* 458 U.S. at 153-54:

> Federal regulations have no less preemptive effect than federal statutes. Where Congress has directed an administrator to exercise his discretion, his judgments are subject to judicial review only to determine whether he has exceeded his statutory authority or acted arbitrarily. *United States v. Shimer,* 367 U.S. 374, 381-382 (1961). When the administrator promulgates regulations intended to preempt state law, the court's inquiry is similarly limited:
>
> "If [h]is choice represents a reasonable accommodation of conflicting policies that were committed to the agency's care by the statute, we should not disturb it unless it appears from the statute or its legislative history that the accommodation is not one that Congress would have sanctioned." *Id.* at 383.

Second, the regulatory action taken by the FCC was also within its authority to ensure efficient operation of the interstate telephone network. In ordering that certain depreciation methods be followed, the FCC was merely exercising its power under section 220(b) of the Act to prescribe classes of property and percentages to be allowed as depreciation. To be sure, that prescription does have an effect on intrastate rates, but the effect will only be ancillary to the FCC's primary statutory directive to regulate interstate communications. While Petitioner VSCC would seek to prohibit even an ancillary effect on intrastate communications, such a result does not harmonize with the FCC's broader mission. As the FCC observed in *Katz, supra,* it is incumbent upon the FCC to exercise its authority in a manner best calculated to serve the needs of the public, and "[t]he fact that the same instruments are used for both interstate and intrastate services and that intrastate service is subject to state and local regulation does not alter the Commission's duties and obligations with respect to interstate telephone facilities." 43 F.C.C.2d at 1332.

Although the FCC noted in its 1982 Memorandum Opinion and Order that it had "never attempted to prevent any State commission from departing from [federal] accounting and depreciation rules," 89 F.C.C.2d at 1106-07, the fact of the matter is that the FCC never found it necessary to do so until the current decade. During the years of monopoly power, when state commissions tended voluntarily to follow federal directives, there was no realistic need to speak in terms of preemption.[13] In the instant case, how-

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[13]Under section 220(i) of the Act, the FCC is required to give notice to each state commission involved, and to allow a reasonable opportunity for each commission to present its views regarding any requirements prescribed. Moreover, the FCC is required to "receive and consider such views and recommendations." Tripartite

ever, several state commissions refused to follow the FCC's determinations concerning depreciation. Although flexibility in depreciation practice presented little threat to the efficient operation of a monopolistic telecommunications industry, improper capital recovery does pose a true threat in today's competitive market. Thus, the FCC reasonably decided to preempt by issuing orders intended to speed capital recovery and improve accuracy of depreciation calculations, thereby enhancing competition.

VSCC makes much of the argument that the FCC was silent on the issue of depreciation for some forty-seven years,[14] but that prior silence does not vitiate the ongoing authority of the FCC to act once it decides that industry conditions merit preemptive regulation. As the Supreme Court observed in *Smith v. Illinois Bell,* 282 U.S. 133, 159-60 (1930), a state's prerogative to regulate survives *"until*

meetings were commonly held between the FCC, state carriers, and state regulatory agencies, with the FCC often able to accommodate state goals without compromising federal policy. *See* FCC Order of January 28, 1982, 88 F.C.C.2d 1223 (1982) (since late 1940s, FCC prescribed depreciation rates after conferring with carrier representatives and staffs of respective state commissions).

[14]Indeed, the FCC itself observed in its initial Memorandum Opinion and Order of 1982 that it was being asked "to repudiate nearly forty years of administrative practice and applicable state court proceedings by adopting an interpretation of Section 220 that would require an unwilling state commission to follow all accounting and depreciation methods prescribed by this Commission. A very compelling showing would be required to persuade us to follow such a course." 89 F.C.C.2d at 1107.

Nonetheless, since the FCC "is not barred from overruling past precedents when it decides that a previously declared rule is no longer sound or appropriate," *New York Telephone Co. v. F.C.C.*, 631 F.2d 1059, 1065 (2d Cir. 1980), certainly it should not be bound to maintain silence once it determines that articulation of a uniform federal policy is warranted.

action has been taken" by a federal agency vested with jurisdiction over the matter. (Emphasis added).[15] Supporting the FCC's decision to regulate is the consideration that a full seventy-five percent of all investment in new plant falls within the intrastate services category. If that large amount of equipment investment should fail properly to reflect its true, rapid depreciation, interstate service would then suffer the effects of delayed innovation.

As noted above, decisions of other Circuits have recognized the necessity for federal preemption of inconsistent state telecommunications policy. In *Computer and Communications Industry Ass'n v. F.C.C.,* 693 F.2d 198 (D.C. Cir. 1982), *cert. denied,* ...... U.S. ......, 103 S. Ct. 2109 (1983), it was found that state tariffing of customer premises equipment ("CPE") "must necessarily yield to the federal regulatory scheme." *Id.* at 214. The federal scheme required that charges for CPE (*e.g.,* home computer terminals, data processing units) be separated from ordinary transmission service charges. Since CPE is used interchangeably for both interstate and intrastate service, such a decision would have a clear ancillary effect on intrastate rates.

[15]In *Smith,* the Court found that, in the absence of federal regulatory action "which could be deemed validly to affect the amount to be charged in connection with intrastate business so as to affect intrastate rates," the jurisdiction of the state is "not to be gainsaid" in determining depreciation amounts for intrastate telephone business. 282 U.S. at 159-60.

See also Northwestern Bell Telephone Co. v. Nebraska State Railway Commission, 297 U.S. 471 (1936), in which the Court found that pending action by the FCC to establish depreciation rates, state control over such rates remained unimpaired. The Act "contemplated no restriction of state control over depreciation rates until the [FCC] had prescribed its own rates." *Id.* at 478.

Whereas the decisions in *Smith* and *Northwestern Bell* were predicated upon the FCC's inaction, the instant appeal presents a clear case of affirmative, preemptive action properly taken by the agency.

Nonetheless, the Court refused to perceive any distinction between the preemption principles to be applied in the case of state ratemaking issues, and those applicable to other state powers. *Id.* at 216. Thus, ancillary effect on intrastate rates was permitted in order to achieve the federal goals of unfettered CPE selection, market competition, and a greater number of equipment and payment options.

The Court in *Computer and Communications Industry* relied in large part on this Circuit's decisions in *NCUC I* and *NCUC II* to support preemption. In *NCUC I,* we held that state regulation that "encroaches substantially" upon federal authority was preempted. 537 F.2d at 793. The conflict in that case dealt directly with policies concerning physical interconnection of non-carrier provided CPE to transmission facilities used jointly for interstate and intrastate needs. Preemption was required, even though we recognized that the FCC had no authority "over local services, facilities and disputes that in their nature and effect are separable from and do not substantially affect the conduct or development of interstate communications." *Id.*

While it may be true that the effects of depreciation policies are more attenuated than the very direct effect produced by physical connection of equipment to interchangeable lines, it cannot be said that depreciation policies are "separable from" interstate communications. Indeed, the conduct and development of interstate communications would undoubtedly be affected by the states' imposition of depreciation policies that slowed capital recovery and innovation. *See also NCUC II,* in which we recognized the preemptive effect, or "federal primacy," of the Commission's registration program for terminal equipment subject to interchangeable use: "If it is admitted—as we think it must be—that the FCC has full statutory authority to regulate joint terminal equipment

to ensure the safety of the national network, then we can discover no statutory basis for the argument that FCC regulations serving other important interests of national communications policy are subject to approval by state utility commissions." 552 F.2d at 1046-47.

The finding of federal primacy was echoed by the Court of Appeals for the Second Circuit in *New York Telephone Co. v. F.C.C.,* 631 F.2d 1059 (2d Cir. 1980), a case which involved an assertion of federal jurisdiction over local exchange service when used in connection with interstate foreign exchange services. Citing *Northwestern Bell* for the proposition that state regulation continued unabated only when the federal agency "had not regulated in [the] area," 631 F.2d at 1066, the Court held that once the FCC acted to impose its own tariff regulations, inconsistent state regulation was necessarily preempted.

Finally, the Court of Appeals for the First Circuit explicitly adopted the rationale of *NCUC I* in *Puerto Rico Telephone Co. v. F.C.C.,* 553 F.2d 694 (1st Cir. 1977). The Court first acknowledged that federal primacy would have the "anomalous" result of ousting Puerto Rico's jurisdiction over equipment used primarily for intrastate calls. However, the Court found it "even more anomalous, in light of FCC's broad [statutory] mandate . . . that § 152(b) ousts federal jurisdiction over all facilities that are also used for intrastate telephone service." *Id.* at 700.[16]

It is true that *Puerto Rico Telephone,* like *NCUC I,* involved a federal policy relating to physical interconnection of CPE that was nonseverable from the interstate communications system. By contrast, the instant appeal raises no question of actual physical impossibility of complying

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[16]Section 152(b) provides, "[N]othing in this chapter shall . . . give the Commission jurisdiction with respect to . . . charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service. . . ."

with dual federal and state regulation; presumably, the carriers could keep accounts in which assets would be separately depreciated for intrastate and interstate purposes.[17] Nonetheless, physical impossibility is but one ground for preemption; frustration of federal objectives provides a rationale at least equally valid. Since inconsistent state regulation poses an impediment to rapid development of interstate facilities, preemption is justified in this case even if "physical impossibility" is not at issue.

In deciding the case, we have been mindful of an observation made by Chief Justice Burger when a member of the Court of Appeals for the District of Columbia in *General Telephone Company of California v. F.C.C.*, 413 F.2d 390 (D.Cir. 1969), *cert. denied,* 396 U.S. 888 (1969). Applying the Act in the context of cable television broadcasting, Chief Justice Burger stated that "[t]he Act must be construed in light of the needs for comprehensive regulation and the practical difficulties inhering in state by state regulation of parts of an organic whole." *Id.* at 398. To be sure, practical difficulties have come to abound in this age of technological innovation since Chief Justice Burger rendered his opinion almost fifteen years ago. In response to some of the difficulties, the FCC's decision to preempt inconsistent state depreciation practices emerges as a reasonable one, designed to foster the statutory goal of an efficient nationwide telecommunications service. Our review satisfies us that the FCC's Memorandum Opinion and Order of January 6, 1983 should be AFFIRMED.

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[17]*But see People of the State of California v. F.C.C.*, 567 F.2d 84, 86 (D.C. Cir. 1977), *cert. denied*, 434 U.S. 1010 (1978). In that case, the Court observed that requiring the maintenance of "'two redundant facilities or [investment] in expensive additional equipment' would frustrate the Commission's responsibility 'to make available, so far as possible . . . a rapid, efficient, Nationwide and world-wide wire . . . communications service with adequate facilities at reasonable charges,'" (*quoting* 47 U.S.C. § 151). Likewise, the expense associated with dual accounting could needlessly inflate the cost of services provided to consumers.

Widener, Circuit Judge, dissenting:

I respectfully dissent.

I am unable to agree that the FCC orders prescribing depreciation practices for common carriers' interstate operations require or warrant preemption of state regulation prescribing different depreciation methods for carriers' intrastate operations. Such preemption conflicts with the FCC's jurisdictional limitations and with this court's reading of the Supremacy Clause in *North Carolina Utilities Commission v. FCC* (*NCUC I*), 537 F.2d 787 (4th Cir.), *cert. denied,* 429 U.S. 1027 (1976), and *North Carolina Utilities Commission v. FCC* (*NCUC II*), 552 F.2d 1036, *cert. denied,* 434 U.S. 874 (1977). The FCC properly recognized these limitations in its order of April 27, 1982, in which it specifically found that its prescription of new accounting procedures "does not preclude state commissions from using other accounting or depreciation procedures for intrastate ratemaking proceedings." *In re* Amendment of Part 31, 89 F.C.C.2d 1094, 1095 (1982), *rev'd,* CC Docket No. 79-105 (F.C.C. Jan. 6, 1983). Its order of January 6, 1983, finding that the States were preempted after all, not only violates statutory strictures on the FCC but also legal limitations on any agency making such a dramatic change in policy.

The Communications Act explicitly deprives the FCC of jurisdiction to regulate directly "charges, classifications, practices" and "facilities," among other things, for or in connection with intrastate communication service. 47 U.S.C. §§ 152(b), 221(b). Unlike other areas of the law in which the term "intrastate" has come to include virtually nothing, communication carrier accounting has until now retained a clear division between its intrastate and interstate components, and this because of the Communications Act itself. Equipment and facilities used for intrastate communications are segregated on the carriers' books from those used

for interstate communications, and the States and the FCC have regulated accounting for such equipment and facilities concurrently within their respective intrastate and interstate spheres. About 75% of depreciable assets are considered intrastate. The section of the Communications Act giving the FCC authority to prescribe depreciation practices for carriers, 47 U.S.C. § 220(b), therefore cannot be read to "require preemption" of state-imposed depreciation practices for the intrastate portion of carriers' operations. More directly put, the FCC does not have jurisdiction to prescribe directly the depreciation practices to be followed as to equipment and facilities allocated to intrastate communications.[1]

The proper analysis of this case, then, is whether the state regulation of depreciation practices as to carriers' intrastate operations conflicts with the FCC regulation of such practices for carriers' interstate operations to a degree that it requires preemption of the state regulation under the Supremacy Clause of the Constitution. This court set forth the rule in *NCUC II* that FCC regulation of facilities and equipment must preempt contrary state regulation where the efficiency or safety of the national communications network or "other important interests of national communications policy" are at stake. *NCUC II,* 552 F.2d at 1046-47. *NCUC I* and *NCUC II* involved FCC deregulation of equipment such as subscribers' telephones used jointly in interstate and intrastate communication. When the FCC rescinded its interstate tariff preventing subscribers from providing their own telephones on the ground that the tariff violated the FCC's statutory mandate to prevent unreasonable and unjustifiably discriminatory rates, *see NCUC II,* 552 F.2d at 1042; *NCUC I,* 537 F.2d at 792, some States rejoined that they could prescribe rules forbidding consumers to connect their own telephones unless the telephones were used exclusively in interstate communication. *See NCUC II,* 552 F.2d at 1043; *NCUC I,* 537 F.2d at 790. This court found that the FCC action preempted the inconsistent state regulation, since the same telephones were used in interstate and intrastate communication and since state regulation prohibiting such connection would negate the federal tariff permitting such connection. *NCUC II,* 552 F.2d at 1043. "Something had to give." *Id.*

[1]As this court noted in *NCUC I,* "[T]he provisions of section 2(b) [47 U.S.C. § 152(b)] deprive the Commission of regulatory power over local services, facilities and disputes that in their nature and effect are separate from and do not substantially affect the conduct or development of interstate communications." *NCUC I,* 537 F.2d at 793.

This sort of conflict simply is not present here. As this court noted in *NCUC I,* "[R]ate making typifies those activities of the telephone industry which lend themselves to practical separation of the local from the interstate in such a way that local regulation of one does not interfere with national regulation of the other." *NCUC I,* 537 F.2d at 793 n. 6.

The supposed conflict here is at least more attenuated, as the majority admits; in my view it is for all practical purposes nonexistent, and has been created by the FCC to rationalize a base for its decision. The Commission claims that if the States do not follow the FCC's depreciation methods they will frustrate the FCC's policy of "encouraging competition" where market conditions will support such a policy. The FCC's claim in essence is that its newly prescribed depreciation methods, which give the carriers more revenue in earlier years, more closely reflect economic reality and thus will increase market efficiency, encourage technological innovation, and otherwise promote competition. Even if this theorizing is correct as to the effect that the FCC's prescribed depreciation procedures for the carriers' interstate operations will have on the highly competitive interstate communications market, I cannot see how nonconforming depreciation methods for the carriers'

intrastate operations can frustrate competition in the interstate communications markets within which there is competition. The only rationale I can find for the FCC's position is that the States, if not required to follow the FCC's lead, will allow the carriers less revenue from the carriers' noncompetitive intrastate operations which the carriers could use to be aggressive in the small area in which they compete with the competitive interstate carriers.[2] Besides being undesirable from the standpoint of the Communications Act, this fact strikes me as encouraging to the point of requiring the use of intrastate monopoly power to finance competition with the competitive interstate market, a practice as dangerous as it is unauthorized, for monopoly should depend for its existence on serving all at reasonable rates and should not be permitted to become a financing tool for competitive ventures.

Moreover, and more fundamentally, if the FCC can achieve preemption of state-prescribed depreciation methods by reciting the shibboleth of encouraging competition with as little showing of federal-state conflict as it has made here, it has effectively written 47 U.S.C. §§ 152(b) and 221 (b) out of the Communications Act. It seems to me that any ratemaking changes that the carriers want can be adopted, if they can persuade the FCC that they need the money, for any FCC adoption may be imposed on the States by virtue of the Supremacy Clause on the ground that the resultant additional revenue will help the carriers in some theoretical way to compete in some market that need not even be specified, as it was not here. The logical result of this decision is to permit the FCC to abrogate completely the state regulation of intrastate ratemaking for the carriers' intrastate operations in violation of the Communications Act.

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[2] I have not even considered that most of the carriers are only marginally engaged in long distance (interstate) communication, that field being dominated by AT&T and its new found competitors.

Ironically, the FCC recognized established law and practice in holding, before it reversed itself only a little more than eight months later, that

> "[w]here state regulation is reconcilable with federal policies or rules, there is no occasion for us to override state agency actions in furtherance of legitimate state regulatory objectives. Section 2(b) [47 U.S.C. § 152(b)] makes clear that Congress did not intend this Commission to foreclose state ratemaking actions unless those actions imperiled 'important interests of national communications policy. . . .' *NCUC II,* 552 F.2d at 1047. We have found in this instance that federal regulation will not be frustrated if carriers maintain additional records for intrastate ratemaking purposes." *In re Amendment of Part 31,* 89 F.C.C.2d 1094, 1108 (1982), *rev'd,* CC Docket No. 79-105 (F.C.C. Jan. 6, 1983)."

The Supreme Court requires that "an agency changing its course . . . supply a reasoned analysis," *Motor Vehicle Manufacturers Association v. State Farm Mutual Automobile Insurance Co.,* 51 U.S.L.W. 4953, 4960 (1983), which must include a "rational connection between the facts found and the choice made." 51 U.S.L.W. at 4956, *citing Burlington Truck Lines v. United States,* 371 U.S. 156, 168 (1962). The FCC's post-hoc reinterpretation of legislative history, on which the majority here quite properly does not depend, combined with the unsupported and unsupportable statements as to the effect on competition of inconsistent state depreciation methods, do not provide even a modicum of reasoned analysis supporting the FCC's decision to interfere in state ratemaking after several decades of affirmatively espousing the opposite conclusion.

The upshot of the case is that the FCC decided that the carriers needed more revenue than the state regulatory

agencies were willing to provide, so it decided to impose different depreciation rates on intrastate equipment for the very purpose of, and thus effectively, raising the intrastate rates of the subscribers[3] just as surely as if it had done so directly. I can find neither justification nor authority in the Communications Act for this action. The final irony is the FCC justification of its action on the ground that it will ". . . bring the benefits of competition to the ratepayers of this country." The "benefits of competition" are higher telephone bills for local ratepayers, and I feel confident that, like the man being ridden out of town on a rail, were it not for the honor of the thing, they had rather walk.

[3]Remarkable as it may seem, these facts are either expressly or implicitly acknowledged in para. 37 of the FCC order as well as other parts.

I note in passing that, as late as *NCUC I* (1976) 97% of the telephone calls in the country were local. The proportion could not be too different today.

United States Court of Appeals
for the Fourth Circuit

No. 83-1136

Virginia State Corporation Commission,
Petitioner,

versus

Federal Communications Commission
and United States of America,
Respondent.

[Filed Oct. 3, 1984]

ORDER

The petitions for rehearing and suggestions for rehearing in banc have been submitted to the Court. Upon the request for a poll of the Court on the suggestions for rehearing in banc, Judge Russell, Judge Phillips, Judge Murnaghan, and Judge Sprouse voted to deny the petitions for rehearing in banc; Judge Widener voted in favor of rehearing in banc; Chief Judge Winter, Judge Hall, Judge Ervin and Judge Chapman are disqualified. Judge Wilkinson abstains from voting.

IT IS ADJUDGED and ORDERED that the petitions for rehearing and suggestions for rehearing in banc are DENIED.

Entered at the direction of Judge Murnaghan, with the concurrence of Judge Sprouse. Judge Widener dissents.

For the Court,

JOHN M. GREACEN
Clerk

Before the
Federal Communications Commission
Washington, D.C. 20554

FCC 82-155
31078
CC Docket 79-105

In the Matter of

Amendment of Part 31,
Uniform System of Accounts
for Class A and Class B
Telephone Companies, of the
Commission's Rules and Regulations
with respect to accounting for
station connections, optional
payment plan revenues and
related capital costs, customer
provided equipment and sale of
terminal equipment.

Memorandum Opinion and Order

Adopted: April 1, 1982 Released: April 27, 1982

By the Commission: Commissioners Fogarty and Jones dissenting and issuing a joint statement.

1. We have before us a petition for clarification of our *First Report and Order* in this proceeding (85 FCC 2d 818 1981)) filed by the National Association of Regulatory Utility Commissioners (NARUC) and a petition for reconsideration of that *Report and Order* filed by the People of the State of California and the Public Utilities Commission of the State of California (California). The *First Report and Order,* commonly known as "Expensing of Station Connections," adopted a number of changes in Part 31 of this Commission's Rules (Uniform System of Accounts for Class A and Class B Telephone Companies). The principal changes

required that future costs of installing new inside wiring and similar costs be included as an expense in Account 605 (Repair of Station Equipment). Such costs have previously been capitalized in Account 232 (Station Connections). The *First Report and Order* also required that the present net investment in inside wiring and investment that will be added during a transition period be amortized over a period of 10 years. That requirement superseded existing depreciation prescriptions for such investment.

2. Both petitions raise the question of whether, and to what extent the adoption of the *First Report and Order* limits the discretion of state commissions to follow different accounting and depreciation procedures for purposes of computing revenue requirements for intrastate telecommunications services. NARUC seeks a clarification of the *First Report and Order* declaring that it does not restrict the discretion of the state commissions and California seeks reconsideration of our decision to the extent that it purports to restrict the discretion of state commissions. GTE Service Corporation (GTE) and American Telephone and Telegraph Company (AT&T) have filed oppositions to the petitions. Those companies contend that the *First Report and Order* does and should restrict the discretion of the state commissions.

3. We have concluded that the *First Report and Order* does not preclude state commissions from using other accounting or depreciation procedures for intrastate ratemaking proceedings. Thus we are granting the NARUC petition insofar as it seeks such a clarification. In view of our conclusion that state commissions are not precluded from using their own accounting and depreciation procedures for intrastate ratemaking purpose it is unnecessary to consider further the California petition and it will be dismissed as moot.

I. Nature of the *First Report and Order*

4. In our Phase II *Final Decision and Order* in Docket 19129, 64 FCC 2d 1, 54-56 (1977), we concluded that it would be desirable to place costs associated with station connections on the causative ratepayer. We accordingly ordered AT&T to submit a plan for changing the accounting treatment of station connection costs that would be consistent with that objective. *Id.* at 110. AT&T responded by filing a petition for rulemaking (RM-3017) that proposed amendments to Part 31 of our Rules. After reviewing that petition, we instituted this proceeding by inviting comments upon a somewhat different proposal to modify accounting for station connections.[1]

5. After reviewing the comments, we concluded that any changes in the accounting or other regulatory treatment of station connections should not include drop or block lines and protectors. We also concluded that changes in accounting procedures would not be sufficient in and of themselves to place other station connection costs on the causative ratepayer. This is the case because costs associated with the provision of inside wiring necessarily must be apportioned between the federal and state jurisdictions as long as inside wiring is provided as a tariffed service subject to dual regulation. Complete unbundling cannot be achieved by expensing rather than capitalizing such costs because both the telephone operations investment and telephone operations expenses are apportioned for purposes of computing an interstate and an intrastate telecommunication service revenue requirement. Complete unbundling could be achieved by determining that the provision of inside wiring should be provided on a detariffed basis. We have, of

[1]Notice of Proposed Rulemaking (CC Docket 79-105), 44 F.R. 48988 (August 14, 1979). We also invited comment upon some other proposed accounting changes that are closely related to station connections.

course, made such a determination with respect to customer premises equipment and have adopted rules to separate that business from the telephone operations that are subject to tariff regulation.[2] We concluded that it would be premature to adopt such a fundamental change in the regulatory status of inside wiring without conducting further inquiry.

6. Nevertheless, we concluded that changes in accounting and depreciation procedures that would facilitate implementation of any decision to change the regulatory status of inside wiring would be desirable in the absence of such a change. We accordingly issued a *First Report and Order* adopting changes in accounting and depreciation rules and a separate *Further Notice of Inquiry* (86 FCC 2d 885(1981)) inviting additional comments with respect to possible changes in the regulatory status of inside wiring. The *First Report and Order* does not produce any change in regulatory status. The interstate portion of the embedded net investment will be reflected in the return component of the interstate telecommunication service revenue requirement and the interstate portion of the annual amortization and the new installation expenses will be reflected in the expense component of that revenue requirement. Unless and until we determine that inside wiring should not be provided as part of a tariffed service, the new accounting rules will not have a greater or different effect than any other accounting rules we have prescribed for the purpose of computing the interstate telecommunication service revenue requirement.

7. Insofar as the petitions seek a determination with respect to this Commission's purpose and intent, we con-

[2]See *Primary Instrument Concept (PIC)*, 68 FCC 2d 1157 (1978); *Second Computer Inquiry Final Decision*, 77 FCC 2d 384 (1980), *recon.*, 84 FCC 2d 50 (1980); *further recon.*, (FCC 81-481, released October 30, 1981).

clude that the *First Report and Order* was not intended to have any preemptive effect that does not arise by operation of law. The discussion of the effects of expensing upon intrastate rates and revenue requirements in that Order was based upon the assumption that all or most state commissions would choose to follow those rules for purposes of computing intrastate telecommunication service rates. Our decision to permit carriers to accelerate the transition to expensing with the approval of state regulatory commissions was also based on the assumption that few, if any, of the state commissions would choose to prohibit expensing for intrastate ratemaking purposes. Such assumptions appeared reasonable because most state commissions have followed most accounting and depreciation procedures prescribed by this Commission in the past and the considerations that led us to conclude that expensing will benefit both carriers and consumers in the long run are equally applicable to intrastate ratemaking. No policy of this Commission would be furthered by requiring state commissions to adhere to the rules we have adopted for purposes of computing the interstate revenue requirement. If carriers adhere to our rules for purposes of computing the interstate revenue requirement, our purpose will be achieved.

8. The participants in this proceeding may not view the preemption issue as a question of intent, but rather as a matter of statutory interpretation. The petitioners may be contending that this Commission could not require state commissions to follow our accounting or depreciation rules for intrastate ratemaking purposes and AT&T and GTE apparently contend that Section 220 of the Communications Act precludes state commissions from departing from any accounting or depreciation rule that has been prescribed by this Commission. To the extent this is the case, this controversy might more appropriately be characterized as a request for a declaratory ruling with respect

to the meaning and effect of Section 220 that is not limited to these particular rules. We do not propose to deny relief because the petitions or oppositions may not be properly labeled. We have concluded, for reasons explained in Part II, that Section 220 does not preclude state commissions from departing from accounting or depreciation rules prescribed by this Commission for purposes of regulating intrastate telecommunication service rates.

II. Effect of Section 220

9. AT&T and GTE rely primarily upon Subsection 220(g) to support their contention that Section 220 precludes the states from departing from our accounting and depreciation rules for purposes of computing intrastate telecommunication service revenue requirements. Subsection (g) provides:

> (g) After the Commission has prescribed the forms and manner of keeping of accounts, records, and memoranda to be kept by any person as herein provided, it *shall be unlawful for such person to keep any other accounts, records, or memoranda than those so prescribed* or such as may be approved by the Commission or to keep the accounts in any other manner than that prescribed or approved by the Commission. Notice of the alterations by the Commission in the required manner or form of keeping accounts shall be given to such persons by the Commission at least six months before the same are to take effect. (Emphasis added)

10. Subsection (g) does not literally impose any restriction upon the power of the states to regulate intrastate rates or the methods state commissions use to determine whether a particular rate will be approved or prescribed. A state commission could theoretically adjust information derived from a carrier's system of accounts for purposes of its own ratemaking without creating any conflict with obligations that Subsection (g) imposes upon carriers.

Nevertheless, it would be extremely difficult as a practical matter for a state commission to perform such ratemaking computations without requiring a carrier to collect and compile some data in some form that might be described as "accounts, records or memoranda." Thus, AT&T and GTE may be contending that Subsection (g) implicitly precludes the use of other accounting methods or systems for other regulatory purposes when this Commission has prescribed methods that must be used for interstate ratemaking purposes.

11. Subsection (a)-(g) of Section 220 were in the main a reprint of provisions contained in Section 20 of the Interstate Commerce Act.[3] Although the Interstate Commerce Act was designed for the regulation of railroads, many of the provisions were extended to communications common carriers and the Interstate Commerce Commission was in the process of developing accounting and depreciation rules for telephone companies at the time the Communications Act was adopted. In the absence of statutory changes or indications to the contrary, it is assumed that whenever the legislature enacts or reenacts a provision in an existing statute it has in mind the previous statute relating to the same subject matter.[4] Unless the context indicates otherwise, words and phrases in a provision that were used in a prior act pertaining to the same subject matter will be construed to be used in the same sense.[5]

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[3]At the time of adoption of Section 220(g) of the 1934 Communications Act, Section 20(5) of the Interstate Commerce Act provided that ". . . it shall be unlawful for such carriers to keep any other accounts, records, or memoranda than those prescribed by the Commission . . ." 41 Stat. 493 (1920). See 49 U.S.C. § 20(5).

[4]Courts have attached great weight to interpretations of Interstate Commerce Act provisions in interpreting the Communications Act. See e.g., *American Telephone and Telegraph Company v. F.C.C.*, 487 F.2d 864, 873-874 (2d Cir. 1973).

[5]See Sutherland, *Statutory Construction*, Section 51.02 (C. Sands ed. 1972) and cases cited therein.

12. The parallel Section 20 language was added to the Interstate Commerce Act by the Hepburn Act of 1906, 34 Stat. 584. The legislative history of the Hepburn Act does not shed any light upon Congressional reasons for prohibiting railroads from maintaining accounts, records on memoranda other than those prescribed by the ICC. Congress may have wished to inhibit the railroads from defrauding investors through fraudulent or sloppy accounting practices or to prevent the railroads from concealing unlawful rebates. There is no indication in the legislative history of the Hepburn Act that the 1906 Congress wished to curb state regulation of railroads. That Act was apparently motivated solely by a desire to make railroad regulation more effective.

13. ICC accounting rules that were promulgated pursuant to Section 20 of the Interstate Commerce Act were challenged in *Int. Com. Commission v. Goodrich Trans. Co.*, 224 U.S. 194 (1912) (hereinafter cited as *Goodrich*). The railroad contended that the ICC had exceeded its authority by prescribing the form of accounts for activities that were not subject to ICC rate regulation. The Supreme Court sustained the ICC accounting rules on the theory that the ICC needed information about such activities in order to regulate the activities that were subject to ICC rate regulation. The Court said (*id.* at 211):

> If the Commission is to successfully perform its duties in respect to reasonable rates, undue discriminations and favoritism, it must be informed as to the business of the carriers by a system of accounting which will not permit the possible concealment of forbidden practices in accounts which it is not permitted to see and concerning which it can require no information. It is a mistake to suppose that the requiring of information concerning the business methods of such corporations, as shown in their accounts, is a regulation of business not within the jurisdiction of the Com-

mission, as seems to be argued for the complainants. The object of requiring such accounts to be kept in a uniform way and to be open to the inspection of the Commission is not to enable it to regulate the affairs of the corporations not within its jurisdiction, but to be informed concerning the business methods of the corporations subject to the act that it may properly regulate such matters as are really within its jurisdiction.

14. *Goodrich* is of limited relevance because that case did not raise any question with respect to the effect of ICC accounting rules upon the regulation of activities that were not subject to ICC rate regulation. Nevertheless, a construction of Section 20 that would have limited the states' discretion to regulate intrastate rail rates would have been inconsistent with the Court's description of the nature and function of the accounting rules.

15. The adoption of an interpretation of Section 20(5) of the Interstate Commerce Act or Section 220(g) of the Commerce Act that restricts state accounting practices for purposes of intrastate ratemaking would also restrict other forms of state or federal regulation that might require accounting records or information that differ from data generated by the rules prescribed for interstate ratemaking. Indeed such an interpretation would appear to preclude carriers from using accelerated depreciation methods for purposes of computing their income taxes since such methods differ from the depreciation methods that have been prescribed for ratemaking purposes.

16. The question of the effect of ICC accounting requirements upon railroad tax accounting did arise before the Communications Act was enacted. The Interstate Commerce Commission had required a railroad to amortize the value of certain abandoned property over a period of 15 years and to charge the amortized amounts as an oper-

ating expense for accounting purposes. The railroad contended in *Kansas City Southern Ry. Co. v. Commissioner of Int. Rev.*, 52 F.2d 372 (8th Cir. 1931) that the Commissioner was required to accept the amortized expenses as a deduction from income because failure to do so would violate Section 20 of the Interstate Commerce Act. The Court summarily rejected that contention.

The Court said (*Id.* at 378):

> The Commission did not purport in requiring the loss for abandonment to be charged to operating expenses to provide any standards for tax authorities to follow. This would be beyond its province. . . . Systems of accounting for railroads under the control of the Commission cannot interfere with the government's system of taxation. The Commission has no power to direct how the Revenue Laws of the United States shall be interpreted or by its orders provide standards to govern the tax authorities.

17. AT&T apparently contends that providing standards for state regulators to follow was within the Interstate Commerce Commission's province and that the ICC had specifically rejected contentions that Section 20 of the Interstate Commerce Act did not give it that power. AT&T's reliance on *Depreciation Charges of Telephone Companies*, 118 I.C.C. 295 (1926), is misplaced. In the *Depreciation Charge* proceeding, NARUC had argued that the words "as soon as practicable" contained in section 20(5) gave the ICC latitude to refrain from prescribing depreciation requirements for the local telephone companies engaged only to an insignificant extent in interstate commerce. In rejecting NARUC's position, the ICC merely held that its obligation under Section 20(5) to prescribe depreciation rates for telephone companies was mandatory, not discretionary.[6] In dicta, the Commission additionally appeared to

[6] 118 I.C.C. at 332-33.

suggest that its authority under Section 20(5) extended to all property "open for use in interstate commerce." Petitioners in CC Docket No. 79-105, however, do not appear to dispute the authority of the FCC, under section 220 of the Communications Act, to extend its accounting and depreciation prescriptions to cover assets used for primarily intrastate purposes. The ICC's 1926 telephone depreciation charge proceeding is silent on the issue of whether federal prescription of depreciation rates preempts the states from prescribing additional and distinct depreciation rates and classifications covering the same property for regulatory purposes.[7]

18. AT&T further cites *Accounting Rules For Telephone Companies,* 203 ICC 13 (1934), in support of its contention that state commissions lack jurisdiction over telephone company accounts insofar as intrastate service is concerned. Here, again, we disagree with AT&T's reading of this opinion. In *Accounting Rules For Telephone Companies* (an advisory opinion for the benefit of the newly created Federal Communications Commission) the ICC concluded, over the objections of the states, only that the federally-prescribed system of accounts should be uniform in its treatment of telephone companies operating among the several states.[8] Indeed, far from preempting the states from independently prescribing separate additional accounts, the ICC expressly recognized that the states might have additional accounting needs and sought to assist the states in this respect by permitting state-prescribed sub-accounts within the federally-required books of account. The ICC stated:

[7]Indeed, the Supreme Court has placed this same construction on the ICC's order in the *Depreciation Charge* proceeding. *Smith v. Illinois Bell Tel. Co.*, 282 U.S. 133, 159 (1930).

[8]See also, *Kansas City So. Ry. v. United States,* 231 U.S. 423 (1931); and *Int. Com. Comm. v. Goodrich Trans. Co., supra.*

> In the measures adopted with respect to the uniform system, we are acting in pursuance of the direction of Congress. Uniformity is the desired and important object. The nature of the undertaking necessarily precludes the incorporation of special provisions covering the requirements of the several State commissions.
>
> We have, however, recognized the needs of the several State commissions in the intrastate regulation which is their duty and have, endeavored to help them in the securing of all necessary information by leaving it open to them to require subdivision of the accounts prescribed.

Since the ICC may not delegate any of its authority under the Interstate Commerce Act to the individual states,[9] ICC acceptance of these state-prescribed sub-accounts may be construed as recognition of the power of the states to require accounts for this own regulatory purposes independent of the scope of the Commission's authority to prescribe accounts for federal purposes.[10]

19. That Commission's conclusion that states may supplement a uniform system would not preclude a conclusion that Section 20 of the Interstate Commerce Act or Section 220 of the Communications Act forecloses states from departing from a federally prescribed accounting system by

[9]See, 49 U.S.C.A. Section 17(2); and Davis, *Administrative Law Treatise,* Ch. 3 (1978).

[10]Significantly, the FCC also has permitted state-prescribed sub-accounts in the USOA books, 47 C.F.R. Section 31.01-2(f) provides the following:

> Nothing contained in the part shall prohibit or excuse any carrier or receiver or operating trustee of any carrier from subdividing the accounts hereby prescribed *in the manner ordered by any State commission having jurisdiction* or to the extent necessary to secure the information required in the prescribed reports to such commission. (Emphasis added.)

adopting accounting methods that are inconsistent with the federal system. That ICC opinion does contain language that indicates that the ICC believed such departures from uniformity would be undesirable, but the ICC did not conclude that such departures are precluded by statute.

20. Supreme Court decisions relating to Section 20 of the Interstate Commerce Act never squarely addressed the question of the extent of the states' power to prescribe accounting and depreciation rules that supplement or deviate from rules prescribed by the ICC. A telephone company did challenge certain state-prescribed depreciation requirements in *N.W. Bell Tel. Co. v. Ry. Comm'n,* 297 U.S. 471 (1936). The Court concluded that Section 20 clearly did not preclude a state commission from adopting and enforcing depreciation rules prior to the adoption of the ICC depreciation rules. The Court expressly declined to determine what effect the adoption of ICC depreciation rules would have upon the state commission's powers.

21. Inasmuch as Section 20 had never been construed to restrict state commissions from requiring carriers to keep additional records for purposes of intrastate ratemaking and court decisions in analogous contexts did not adopt an expansive interpretation of that provision, the reenactment of that language should not be interpreted to restrict state commissions from keeping such additional records in the absence of clear evidence that the 1934 Congress intended to produce that result. AT&T and GTE would infer such an intent from that Congress failure to enact a proposed subsection 220(j) that would have provided:

> Nothing in this section shall (1) limit the power of a State commission to prescribe, for the purposes of the exercise of its jurisdiction with respect to any carrier, the percentage rate of depreciation to be charged to any class of property of such carrier, or the composite depreciation rate, for the purpose of determining charges, accounts, records, or practices;

> (2) relieve any carrier from keeping any accounts, records, or memoranda which may be required to be kept by any State commission in pursuance of authority under State Law.[11]

22. This version of section 220(j) passed the House but was eliminated from the Senate bill. The revised Senate version of section 220(j) provided instead:

> The Commission shall investigate and report to the Congress whether in its opinion legislation is desirable (1) authorizing the Commission to except the carriers of any particular class or classes in any State from any of the requirements under this section in cases where such carriers are subject to State commission regulation with respect to matters to which this section relates; and (2) permitting the State commissions, in pursuance of authority granted under State Law, to prescribe their own percentage rates of depreciation or systems of accounts, records, or memoranda to be kept by carriers.[12]

23. The Conference Committee drafted a compromise that retained the House version of subsection 220(h) and substituted a new subsection 220(j) for both the House and Senate versions. The Conference Committee version of Section 220, which was enacted without further modification, also included a subsection (i) that did not parallel Interstate Commerce Act language. Subsections (h)-(j) provided:

> (h) The Commission may classify carrier subject to this Act and prescribe different requirements under this section for different classes of carriers, and may, if it deems such action consistent with the public in-

[11] S. 2910, 73d Cong., 2d Sess. Section 220(j) (February 20, 1934); H.R. 8301, 73d Cong., 2d Sess. Section 220(j) (February 27, 1934).

[12] S. 3285, 73d Cong., 2d Sess. Section 220(j) (March 8, 1934).

terest, *except the carriers of any particular class or classes in any state from any of the requirements under this section in cases where such carriers are subject to State commission regulation with respect to matters to which this section relates.* (Emphasis added)

(i) The Commission, before prescribing any requirements as to accounts, records, or memoranda, shall notify each State commission having jurisdiction with respect to any carrier involved, and shall give reasonable opportunity to each such commission to present its views and recommendations.

(j) The Commission shall investigate and report to Congress as to the need for legislation to define further or harmonize the powers of the Commission and of State commissions with respect to matters to which this section relates.

24. AT&T and GTE argue that statements by witnesses at the committee hearings both in favor of and in opposition of the original version of Section 220(j) support the position that Congress intended in dropping this provision to preempt the states for all purposes. They contend that statements by witnesses from both sides were premised on the believe that absent a provision similar to original section 220(j) the states would be bound by federal accounting and depreciation prescriptions in their local regulation. We disagree.

25. The record of the Congressional hearings indicates little more than that the supporters of original section 220(j) believed that the provision was desirable to resolve a previous unsettled point of law under the predecessor provision of the Interstate Commerce Act. This desire on the part of the state commissions to have Congress explicitly recognize the authority of the states to prescribe accounts and depreciation rates for local regulatory purposes is

reflected in the following statements of J.E. Benton, NARUC's general solicitor (emphasis added).

Section 220, which is the section giving the Commission jurisdiction to prescribe accounts and reports, also takes account of local conditions and safeguards the powers of State commissions in the matters of depreciation and of accounting regulations. *The State commissions are very solicitous that the act shall be so phrased that it cannot be construed* as imposing any depreciation regulation promulgated by the Federal Commission upon the regulatory agencies of the States.

. . . .

Ever since the power to fix depreciation rates was given to the Interstate Commerce Commission in 1920, *the State commissions have been apprehensive that when an order finally came to be fixed by a Federal Commission it would be pointed to by the utilities as depriving the State commissions thereafter of going into the question of depreciation in rate cases . . .*

. . . .

[W]e do not ask for any particular form of words, but there should go into the act a provision which makes it clear that in the administration of their laws for the regulation of rates, the State commissions shall have the power in rate cases to determine what allowances shall be made for depreciation in the rates which are fixed.

[T]he State Commissions believe that it is not in the public interest that the act shall contain a mandate to the Federal commission to fix rates of depreciation unless *it shall be made entirely clear* in the act that such determination is for the use of the Federal commission only and is not to affect the State commissions in their regulatory work.

. . . .

That section merely proposes to provide, in plain terms, that the control of intrastate telephone business as now exercised by the States, shall continue to be exercised by them without interference by the Federal Commission.[13]

26. Several witnesses opposed original section 220(j) on the various grounds that it would create the possibility of unreasonably burdening the carriers with the cost of multiple sets of books,[14] that it would destroy the uniform system of accounts[15] and that it would create conflicts in the exercise of federal and state jurisdiction.[16] Only one opposing witness, however, specifically expressed the view that the then-current law prohibited the states from prescribing accounts and depreciation rates for their own purposes, and this statement was tentative.[17]

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[13]Hearings on H.R. 8301, Before the Committee on Interstate and Foreign Commerce, U.S. House of Representatives, 73d Cong., 2d Sess. (April 10, 1934), pp. 136-44 (Emphasis added.); see also, Hearings on S. 2910 Before the Committee on Interstate Commerce, United States Senate, 73 Cong., 2d Sess., (March 9-10, 13-15, 1934) pp. 178-84.

[14]See, *e.g.*, Hearings on S. 2910, p. 96; and Hearings on H.R. 8301, p. 191. (Statements of W.S. Gifford, President, AT&T.)

[15]See, *e.g.*, Hearings on S. 2910, p. 208; and Hearings on H.R. 8301, p. 96. (Letters of F. McManamy, Commissioner, ICC)

[16]See, e.g., Hearings on H.R. 8301, p. 243 (Statement of F.B. MacKinnon, President, United States Independent Telephone Association. How this version of section 220(j) would undermine the uniformity of the *federal* accounting system or result in conflict between federal and state authorities was not explained.

[17]MR. GIFFORD. [Section 220(j)] throws the whole uniform accounting of the telephone industry out of line too, as I see it. It would make it necessary to keep two sets of accounts, one for the Federal Commission and one for the State commission, because each State may provide for a different system of accounting. The States will require one system of accounting, and we will also have

27. Even if all the witnesses who testified concerning original section 220(j) had consistently and clearly expressed the view that the states lacked authority to prescribe additional accounts and depreciation rates absent this provision, we could accord little weight to the statements given the silence contained in the Congressional reports.[18] In striking the compromise which became the law, Congress was completely silent as to its intent in eliminating the House version of Section 220(j).

28. H. Rep. No. 1918 describes the Conference provisions as follows (p. 47):

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to keep accounts for the Federal system of accounting. I do not think it is workable.

. . . .

MR. MAPES. *Do the States now require you to keep accounts of any kind?*

MR. GIFFORD. *No.* The present law, the interstate commerce law, calls for accounts and that controls, as against the State laws.

MR. MAPES. Exclusively.

MR. GIFFORD. *Exclusively, and has since 1913, I think,* when the act was passed. I think the matter ought to be given very serious consideration before we go into that.

Hearings on H.R. 8301, pp. 191-92. (Emphasis added).

[18]Generally, statements made by interested parties as to the nature and effect of a bill are accorded to little or no weight if not incorporated into a committee report. These statements are very weak evidence that the legislature adopted the assumed interpretation, in view of the possibility that the committee believed the changes were unnecessary because the assumed interpretation was erroneous. See, *Sutherland Statutory Construction*, Section 48.10, and cases cited therein.

Similarly, contrary to the contention of AT&T, the mere existence of provisions in the Natural Gas Act, 15 U.S.C.A. Section 717(g) and the Federal Power Act, 16 U.S.C.A. Section 825(a) specifically reserving to the states the right to prescribe additional accounting regulations does little to assist its cause in this case. *See, e.g., Keifer & Keifer v. Reconstruction Finance Corp.*, 306 U.S. 381 (1939).

Section 220(j) of the Senate bill (accounts and depreciation charges) authorizes the Commission to investigate and report to Congress upon the desirability of legislation authorizing the Commission to except the carriers of any particular class or classes in any State from the requirements of the section and permitting State commissions to prescribe their own percentage rates of depreciation and systems of accounts for carriers. The House amendment (sec. 220(h)) specifically authorizes the Commission to except carriers of any particular class or classes in any State and provides (in sec. 220(j)) that the section shall not limit the power of the State commissions to prescribe percentage rates of depreciation or to require the keeping of accounts.

29. At most this legislative history indicates that the 1934 Congress was not sure whether reenactment of the Interstate Commerce Act language would or would not preempt state accounting and depreciation rules and did not choose to resolve the question at that time. One might infer that Congress believed Subsection (g) did not preempt inconsistent state commission accounting and depreciation practices. If Subsection (g) produced that effect, any further legislation to "harmonize" the powers of the regulatory commissions might be superfluous.

30. The carriers' contention that Subsection (i) demonstrates that the 1934 Congress believed it had preempted State commission accounting and depreciation rules is not persuasive. Congress undoubtedly correctly anticipated that most State commissions would not choose to create a complete system of accounts and would be vitally interested in any rules developed by this Commission. The adoption of special notice and consultation requirements does not demonstrate that Congress assumed all states would be required to adhere to all federal accounting or depreciation rules.

31. Subsections (h)-(j) indicate that the 1934 Congress wished to achieve as much uniformity as possible without coercing any state commission to use ratemaking methods it found unacceptable. This Commission has proceeded in a manner that is consistent with that purpose for nearly four decades. We have always given special consideration to the needs and views of state commissions in developing accounting and depreciation rules and most State commissions have chosen to follow most accounting and depreciation rules prescribed by this Commission. Departures have nonetheless occurred from time to time.[19] This Commission has never attempted to prevent any State commission from departing from our accounting and depreciation rules. Indeed we have expressly recognized that State commissions have a right to do so.

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[19]For example, our *Order on Reconsideration* (FCC 79-678, released November 6, 1979) with respect to our Docket 21230 decision adopting revised accounting rules for plant under construction noted that many states have adopted different accounting procedures for plant under construction. We expressly acknowledged in paragraph 9 of that order that our decision would not inhibit the desecration of the state commissioners. We said:

> As our *Final Order* in Docket 21230 makes clear, we have in no way attempted to influence, or interfere with, the rate making prerogatives of the New York PSC or any other state commission. The states remain free to establish intrastate rates on whatever lawful basis they choose. The fact that separate accounting information will have to be retained to accomplish this and the fact that the gathering and retention of this information may involve additional cost does not, in our view, involve any significant interference with state control over intrastate rates.

States have also departed from accounting practices we have prescribed in other situations. Florida requires full nomalization of taxes, this Commission does not. Many states have authorized or required a deferral of expenses when we do not.

32. NARUC correctly notes that this Commission previously has recognized that states are not obligated to follow F.C.C. prescribed accounts in intrastate ratemaking proceedings. Thus, *In the Matter of Amendment of Part 31, Uniform Systems of Accounts for Class A and Class B Telephone Companies*. 68 F.C.C. 2d 902, 906-07 (1978), we stated:

> It should be pointed out that we are not in any way attempting to influence the intrastate ratemaking decisions the several state commissions may make in this area. Of course, they are free to adopt the same ratemaking treatment for plant under construction and interest during construction as we adopted in Docket 19129, or they may prefer to follow a different treatment. We are familiar with at least one state that by statute must follow a different treatment. We do not believe, nor is it intended, that the accounting changes adopted in this proceeding impinge upon the ratemaking prerogatives of any state commission. Further, as everyone is aware, different treatment is already given to a number of items for intrastate vs. interstate ratemaking as well as among the several state commissions for intrastate ratemaking.

See also, *Notice of Proposed Rulemaking,* in CC Docket No. 79-105, at para. 7; and 47 C.F.R. Section 31.01-2(f).

33. Telephone companies have rarely challenged past state commission departures from accounting or depreciation rules prescribed by this Commission. Such challenges have not been successful. Pacific Telephone did challenge a California Public Utility Commission rate order on the grounds that it was invalid because it was based upon depreciation methods that departed from methods prescribed by this Commission. The California Supreme Court

rejected that contention in *Pacific Tel. and Tel. Co. v. California,* 401 P.2d 353, 372-73 (1965).[20]

34. Thus, AT&T and GTE are asking us to repudiate nearly forty years of administrative practice and applicable state court precedents by adopting an interpretation of Section 220 that would require an unwilling state commission to follow all accounting and depreciation methods prescribed by this Commission. A very compelling showing would be required to persuade us to follow such a course.

35. GTE appears to argue that the existence of such state accounting and depreciation departures would make impossible a federal scheme of accounting and depreciation prescriptions. Past departures have not produced such an effect. If carriers maintain the records we require for purposes of interstate ratemaking, federal regulation will not be frustrated if carriers maintain additional records for other purposes.

36. Unlike GTE, AT&T appears to concede this point. AT&T argues, however, that the sanctioning of state accounting and depreciation departures from the prescriptions contained in the *First Report and Order* would permit the states to burden the carriers with the costs of maintaining multiple sets of records. We, of course, are not free to preempt the states on the theory that they otherwise may impose administrative costs on the carriers in the course of engaging in intrastate ratemaking.

37. Our analysis of Section 220 is supported also by Section 2(b) of the Act, 47 U.S.C. § 152(b), which provides in pertinent part that "nothing in this Act shall be

[20]The Florida Public Service Commission concluded that it is not required to use depreciation methods prescribed by this Commission. *Southern Bell Telephone* and *Telegraph Co.,* 66 PUR 3d 1, 57-58 (1966).

construed to apply or to give the Commission jurisdiction with respect to (1) charges . . . for or in connection with intrastate communication service by wire or radio of any carrier . . ." Section 2(b) does not prohibit preemption of state regulatory actions that might interfere with or tend to frustrate policies or rules we have adopted to carry out statutory objectives with respect to interstate and foreign communications. *North Carolina Utilities Commission v. FCC,* 552 F.2d 1036 (4th Cir. 1977), *cert. denied* 434 U.S. 874 (1977) [hereinafter cited as *NCUC II*]; *North Carolina Utilities Commission v. FCC,* 537 F.2d 787 (4th Cir. 1976), *cert. denied* 429 U.S. 1027 (1976); *Puerto Rico Telephone Co. v. FCC,* 553 F.2d 694 (1st Cir. 1977); *People of California v. FCC,* 185 U.S. App. D.C. 217, 567 F.2d 282 (1966), *cert. denied* 325 U.S. 837 (1966). But where state regulation is reconcilable with federal policies or rules, there is no occasion for us to override state agency actions in furtherance of legitimate state regulatory objectives. Section 2(b) makes clear that Congress did not intend this Commission to foreclose state ratemaking actions unless those actions imperiled "important interests of national communications policy. . . ." *NCUC II,* 552 F.2d at 1047. We have found in this instance that federal regulation will not be frustrated if carriers maintain additional records for intrastate ratemaking purposes.

Ordering Clauses

38. Accordingly, IT IS HEREBY ORDERED THAT the petition for clarification of the National Association of Regulatory Utility Commissioners, filed April 30, 1981, IS GRANTED to the extent reflected herein.

39. IT IS FURTHER ORDERED THAT the petition for reconsideration of the People of the State of California and the Public Utilities Commission of the State of California, filed April 30, 1981, IS DISMISSED as moot.

40. IT IS FURTHER ORDERED THAT the Secretary of the Federal Communications Commission shall cause this *Memorandum Opinion and Order* to be published in the Federal Register and in the Federal Communications Reports.

41. IT IS FURTHER ORDERED THAT the Secretary shall cause to be served on each party of record in CC Docket No. 79-105 and each state commission having jurisdiction over intrastate communication service a copy of this *Memorandum Opinion and Order.*

FEDERAL COMMUNICATIONS COMMISSION*

/s/ William J. Tricarico
Secretary

*See attached joint dissenting statement of Commissioners Joseph R. Fogarty and Anne P. Jones.

April 1, 1982

Joint Dissenting Statement
of
Commissioners Joseph R. Fogarty and Anne P. Jones

In Re: Expensing of Station Connections (CC Docket No. 79-105)—Petitions for Clarification and Reconsideration.

We dissent from today's majority decision that the First Report and Order in this proceeding does not preempt State regulators from imposing accounting and depreciation rules for inside wiring which are inconsistent with those prescribed by this Commission.

In its *First Report and Order* the Commission required that account 232 of the Uniform System of Accounts be separated into two subclasses, "Station Connections—inside wiring" and "Station Connections—Other". We further required that the existing investment in Station Connections—inside wiring be amortized over a period of ten years, which represents an accelerated depreciation in contrast to past practices, and that all new investment for inside wiring be expensed rather than capitalized.

Because we wished to ameliorate the effect such an expensing plan could have upon local rates, the Commission required that expensing take place over a four-year period. In discussing this phase-in approach, the Commission stated that ". . . we want to allow all carriers and *state regulatory agencies* as much flexibility as possible in shifting from capitalization to expensing. Hence, for those carriers who feel that a flash-cut approach will not be too disruptive to their operations and who gain state regulatory approval, *we will allow them* to use a flash-cut approach".[1] It is clear from this discussion that the Commission intended its decision to be binding upon the States. Since only approxi-

[1]*First Report and Order,* 85 FCC 2d 818, 829 (Emphasis added).

mately one-quarter of inside wiring costs are apportioned to the interstate jurisdiction, a phase-in which embraced only these costs would result in about 6¼, 12½, 18¾ and 25 percent of all new inside wiring costs being expensed instead of capitalized in each of the four years respectively. Surely this is not what the Commission intended. It would be nonsensical to order such a time-and resource-consuming process to achieve only such a limited effect.

We also intended the decision in our *First Report and Order* to be binding upon the States for the sound policy reason that telephone operating companies need to obtain a more rapid recovery of capital in order to modernize their plant to meet consumer needs and increased competition in the future.

Further, the FCC may ultimately order the complete detariffing and deregulation of inside wiring. The Commission anticipated this possibility in the *First Report and Order* when we said:

> ". . . we believe that the final answer rests not with accounting changes but rather with the ultimate deregulation of this activity. This is nothing more than a logical extension of the recommendations made by parties, our decision in Docket 20828 and our overall regulatory scheme to introduce competition whenever technological and economic circumstances are conducive to such a change."[2]

As the Commission has seen in the deregulation of customer premises equipment, asset valuation is a very difficult problem. If inside wiring is similarly deregulated, asset valuation will be made more difficult if this account is not capped. Furthermore, if there are two sets of accounting books required (one Federal and one State), any eventual detariffing of the inside wiring account will

[2]Ibid, 827.

be made all the more difficult, since inside wiring must be deregulated *in toto* or not deregulated at all (unless the Commission contemplates deregulating only the first one-fourth of the length of wire between the protector block and the wall outlet).

Disregarding these important considerations of Federal policy, the majority has decided that the Commission did not intend to preempt inconsistent State accounting and ratemaking practices and procedures with respect to the Station Connections-inside wiring account. At the same time, the majority allows that the Federal Communications Act—and, in particular, Section 2(b) thereof—"does not prohibit preemption of state regulatory actions that might interfere with or tend to frustrate policies or rules we have adopted to carry out statutory objectives with respect to interstate and foreign communications."[3] The continued capitalization of inside wiring by State regulatory authorities will in fact imperil and frustrate "important interests of national communications policy . . ."[4]—enhanced capital recovery and the effective implementation of any ultimate FCC decision on ordering the detariffing and deregulation of inside wiring[5].

We would not—and the majority should not—"defer to the States" on critical capital recovery issues affecting the continued viability and competitiveness of our Nation's telephone industry in providing increasing essential interstate, as well as intrastate, facilities and services. This

[3]MO&O, para. 37 (Citations omitted).

[4]*North Carolina Utilities Commission v. FCC*, 552 F.2d 1036, 1047 (4th Cir. 1977), *cert. denied* 434 U.S. 874 (1977).

[5]Several State commissions have already acted to deny the application of FCC policy on inside wiring and related depreciation at the State level, and others appear to be in the process of following suit. Alabama (Sept. 4, 1981), Nebraska (Sept. 1, 1981), South Dakota (Feb. 2, 1982), and Missouri (Nov. 27, 1981) have disapproved carrier filings seeking the expensing of inside wiring.

Commission has thrust the telephone industry into the brave new world of telecommunications competition and in doing so has overidden the strenuous and in many cases intransigent objections of many State commissions. It is therefore oddly inappropriate for this same Commission now to be so reticent about preempting the State jurisdictions from denying the industry the capital recovery necessary for its full and fair participation in this new competitive world. Here, the Commission curiously appears to have lost the courage of its pro-competitive convictions.

Because the majority's decision is inconsistent with the clear preemptive thrust and intent of the Commission's *First Report and Order* in this proceeding and, further, fails to recognize and support the integrity of our pro-competitive policies, we dissent.

Before the
Federal Communications Commission
Washington, D.C. 20554

CC Docket No. 79-105

In the Matter of

Amendment of Part 31, Uniform System of Accounts
for Class A and Class B Telephone Companies,
of the Commission's Rules and Regulations
with respect to accounting for station connections,
optional payment plan revenues and related capital costs,
customer provided equipment and sale
of terminal equipment.

ERRATUM

Released: April 30, 1982

The Memorandum Opinion and Order, FCC 82-155, released April 27, 1982, in the above-entitled matter is corrected to include Commissioner Rivera dissenting after the phrase "By the Commission".

FEDERAL COMMUNICATIONS COMMISSION

/s/ William J. Tricarico
William J. Tricarico
Secretary

Before the
Federal Communications Commission
Washington, D.C. 20554

CC Docket No. 79-105
RM-3017

In the Matter of
Amendment of Part 31, Uniform System of Accounts
for Class A and Class B Telephone Companies,
of the Commission's Rules and Regulations
with respect to accounting for station connections, optional
payment plan revenues and customer provided equipment
and sale of terminal equipment.

Petition for Declaratory Ruling on Question
of Federal Preemption Involving Order of the Public
Utilities Commission of Ohio in Conflict
with (i) FCC Prescriptions Under Section 220 of the
Communications Act and (ii) Established FCC Policies

MEMORANDUM OPINION AND ORDER

Adopted: *December 22, 1982* Released: *January 6, 1983*

By the Commission: *Commissioner Fogarty issuing a separate statement.*

1. The Commission has before it a Petition for Reconsideration filed on June 7, 1982, by the American Telephone and Telegraph Company, on behalf of itself and the associated Bell System Operating Companies (AT&T). AT&T seeks reconsideration of the Commission's decision in *Amendment of Part 31,* 89 FCC 2d 1094 (1982) (hereinafter cited as *Preemption Order*), in which the Commission determined that Sections 220(a) and 220(b) of the Communications Act of 1934, as amended, 47 U.S.C. 220(a) and

220(b), did not preempt state commissions from applying different accounting and depreciation procedures for purposes of intrastate ratemaking proceedings[1] The *Preemption Order* was a reconsideration of *Amendment of Part 31,* 85 FCC 2d 818 (1981) (hereinafter cited as *Expensing Order*).

2. The Commission also has before it a Petition for Declaratory Ruling filed on June 7, 1982, by General Telephone Company of Ohio (GTE of Ohio). This petition requests that the Commission preempt an order of the Public Utilities Commission of Ohio (Ohio) that denied GTE of Ohio the same depreciation rates for intrastate purposes as had been prescribed by this Commission. GTE of Ohio contends that Section 220(b) established the rate prescribed by the Commission as the only depreciation rate the company could utilize.

3. The Commission established a joint reply period for the two petitions, utilizing the pleading cycle for comments in response to the Petition for Reconsideration, and allowed parties to cross-reference their pleadings where appropriate. In addition to pleadings filed by the petitioners and the GTE parties, comments or reply comments were filed by the Arkansas Public Service Commission (Arkansas), Ohio, the People of the State of California and the Public Utilities Commission of the State of California (California), the Virginia State Corporation Commission (Virginia), the National Association of Regulatory Utility Commissioners

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[1] On June 8, 1982, GTE Service Corporation, on behalf of itself, United Telephone System, Inc., and Continental Telecom, Inc. (hereinafter referred to as GTE), filed a Petition for Clarification of the Commission's *Preemption Order.* This petition was dismissed as untimely. *Amendment of Part 31,* Mimeo No. 4766 (released June 24, 1982). However, the Commission stated that it would consider the substance of the petition in connection with AT&T's petition.

(NARUC), the United States Independent Telephone Association (USITA), the Office of Consumers' Counsel, State of Ohio (Consumers' Counsel), the United States Telephone System Inc. and the Idaho Public Utilities Commission (Idaho). A summary of the comments is contained in Appendix A. Below we consider the issues raised on reconsideration, after which we shall consider the question presented by GTE of Ohio's Petition for Declaratory Ruling.

I. *Background*

4. In *Docket No. 19129,* 64 FCC 2d 1, 54-56 (1977), we concluded that it would be desirable to have the causative rate payer bear the costs associated with station connections. We directed AT&T to file a plan for accomplishing this objective. Following AT&T's submission we initiated this proceeding, albeit with a somewhat different approach for modifying the accounting for station connections than proposed by AT&T.

5. After reviewing the comments, we concluded that the drop, block and protector portion of station connections should not be included in any accounting or regulatory revisions. We also concluded that our objective of placing the costs of station connections on the cost causative customer could not be achieved by means of an accounting change alone. This is so because costs associated with the provision of inside wiring must be apportioned between the federal and state jurisdictions as long as inside wiring is provided as a tariffed service subject to dual jurisdiction. Complete unbundling could be achieved by requiring inside wiring to be provided on a detariffed basis, as was done with customer premises equipment. Accordingly, we initiated a further inquiry to explore the detariffing concept further, *Amendment of Part 31,* 86 FCC 2d 885 (1981).

6. Nevertheless, we concluded that changes in accounting and depreciation procedures that would begin expens-

the inside wiring portion of the station connection account would be in the public interest, and would facilitate the deregulation of the provision of inside wiring if the Commission should later decide to take that approach. The principal changes required that future costs of installing inside wiring and similar costs be included as an expense in Account 605, Repair of Station Equipment. Such costs were previously capitalized in Account 232, Station Connections. The expensing of these costs would be phased in over a four year period unless a carrier obtained state commission approval to expense one hundred percent immediately. The *Expensing Order* also required that the present net investment in inside wiring and the investment capitalized during the phase-in period be amortized over a ten year period. These expensing and amortization rules replaced the depreciation procedures that had previously applied to the inside wiring portion of the station connections account.

7. On reconsideration, we concluded that the *Expensing Order* was not intended to preempt state commissions from utilizing other depreciation or accounting procedures for intrastate ratemaking proceedings, unless such preemption occurs as a matter of law. Our discussion was based in part on an assumption that most or all of the state commissions would follow our lead. We also indicated that Section 220 does not preclude state commissions from departing from accounting and depreciation rules prescribed by this Commission for purposes of regulating intrastate communications services. In reaching this conclusion, we reviewed Section 20(5), the Interstate Commerce Act predecessor of the accounting and depreciation provisions contained in Section 220. We concluded that nothing in the history of Section 20(5) provided any indication of whether that provision had been intended to preempt state commissions from prescribing divergent depreciation rates when the Interstate Commerce Commission (ICC) had prescribed a rate. We stated:

> [i]nasmuch as Section 20 had never been construed to restrict state commissions from requiring carriers to keep additional records for purposes of intrastate ratemaking and court decisions in analagous contexts did not adopt an expansive interpretation of that provision, the reenactment of that language should not be interpreted to restrict state commissions from keeping such additional records in the absence of clear evidence that the 1934 Congress intended to produce that result.

Preemption Order, supra at 1102.

8. We also reviewed the legislative history of the Communications Act and concluded that Congress had been uncertain of the preemptive effect of reenacting the Interstate Commerce Act language and that it apparently did not want to resolve the question at that time. We concluded that Congress had been attempting to obtain as much uniformity as possible without coercing any state commission to use ratemaking methods which it might find unacceptable. We found that we had proceeded in a manner consistent with this purpose for nearly four decades, noting that we had recognized divergent practices by state commissions from time-to-time. The language of Section 2(b)(1) was found to support the interpretation that state commissions are not precluded from applying different accounting and depreciation procedures from this Commission. The *Preemption Order* concluded by finding that nothing in the Act precluded us from preempting state commission actions that might interfere with or tend to frustrate policies or rules we have adopted to carry out statutory objectives with respect to interstate or foreign communications, but we also found that federal regulation would not be frustrated if carriers maintain additional records for intrastate ratemaking purposes.

II. *Discussion*

9. The question presented in the reconsideration petition is a clearly delineated controversy over whether Section 220(b) preempts state depreciation prescriptions that are inconsistent with the rates prescribed for classes of property by this Commission, or, whether Section 2(b)(1) or Section 221(b) reserve to the states the right to prescribe their own depreciation rates for intrastate regulatory purposes. Alternatively, it is argued that the Commission should preempt inconsistent state depreciation rates pursuant to its authority to preempt state actions which would frustrate or interfere with the accomplishment of federal objectives. *See North Carolina Utilities Commission v. FCC,* 537 F.2d 787 (4th Cir. 1976), *cert. denied,* 429 U.S. 1027 (1976) (hereinafter cited as *NCUC I*). The *Preemption Order* was the first time the Commission had squarely addressed the preemptive effect of a prescribed depreciation rate, despite having prescribed rates for more than thirty years. No federal court has addressed the question of the preemptive effect of a Commission prescribed depreciation rate.[2]

10. It is argued that the Commission erred in the earlier decision by concentrating on Sections 220(a) and 220(g) rather than properly analyzing Section 220(b), the provision dealing directly with depreciation. A careful review of AT&T's and GTE's pleadings and a thorough reevaluation

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[2]The United States Supreme Court has held that state commissions may prescribe depreciation rates where the empowered federal commission has not prescribed rates. *Northwestern Bell Telephone Co. v. Nebraska State Railway Comm.,* 297 U.S. 471 (1936). The Court specifically reserved judgment on the effect of prescribed rates by the federal commission.

of the entire question of the Commission's depreciation jurisdiction leads to the conclusion that the evaluation in the *Preemption Order* did not sufficiently consider the effect of Section 220(b). Accordingly, we shall undertake to evaluate anew the scope of the Commission's jurisdiction under Section 220(b).

11. Before turning to the analysis of the statutory provisions, it is necessary to understand the relationship between capitalizing and expensing a transaction or economic event. When an event is capitalized, its cost is recorded on the company's books to be recovered over some future period through depreciation charges to operating expense. Depreciation as used here is an accounting convention for allocatively spreading the original cost, less net salvage, over the useful life of a capital asset. Thus, for there to be depreciation there must be costs that are to be recovered over more than one accounting period. However, when the decision to expense is made, all costs are to be recovered at one time. Thus, the decision to expense is a determination that there is no category of asset for which depreciation expense will be allowed. It is therefore clear that the decision to commence expensing the inside wiring portion of station connections involves questions of depreciation policy

12. The law is clear that federal regulation should not be presumed to preempt state regulations without clear evidence of either congressional design to preempt the field or that state regulatory activities would obstruct the accomplishment and execution of the full purposes and objectives of Congress. *Florida Lime and Avocado Growers, Inc. v. Paul,* 373 U.S. 132, 141 (1963), *Hines v. Davidowitz,* 312 U.S. 52, 67 (1941). Our review reveals that both crite-

ria are satisfied in this case. In reaching this conclusion we analyzed the language of Section 220, the legislative history, relevant court cases, and our regulatory objectives.

A. *Statutory Language*

13. The Commission's express jurisdiction with respect to depreciation is set forth in Section 220(b). That section provides:

> The Commission shall, as soon as practicable, prescribe for such carriers the classes of property for which depreciation charges may be properly included under operating expenses, and the percentages of depreciation which shall be charged with respect to each of such classes of property, classifying the carriers as it may deem proper for this purpose. The Commission may, when it deems necessary, modify the classes and percentages so prescribed. Such carriers shall not, after the Commission has prescribed the classes of property for which depreciation charges may be included, charge to operating expenses any depreciation charges on classes of property other than those prescribed by the Commission, or, after the Commission has prescribed percentages of depreciation, charge with respect to any class of property a percentage of depreciation other than that prescribed therefor by the Commission. No such carrier shall in any case include in any form under its operating or other expenses any depreciation or other charge or expenditure included elsewhere as a depreciation charge or otherwise under its operating or other expenses.

14. The plain language of the statute is express and unequivocal. Section 220(b) says the Commission "shall" make depreciation prescriptions, and that carriers "shall not" charge depreciation different than that prescribed

by the Commission. That this preempts inconsistent state action is further indicated in Section 220(h) which gives the Commission discretion to "except" carriers from the requirements of Section 220 "where such carriers are subject to state commission regulation."

15. The requirement of Section 220(i) that states be given an opportunity to comment before the Commission prescribes "any requirements as to accounts, records and memoranda" is consistent with an interpretation that states are preempted when the Commission has acted in the depreciation area. By providing that states be given notice, Congress ensured that state needs for accounts, records and memoranda brought to the Commission's attention would be considered. Such a procedure assures that the states' needs and legitimate interests are met.

16. In setting the duties of the Commission and the prohibitions on the carriers subject to the Act, Congress spoke of depreciation in general terms without any attempt to make distinctions between either "intrastate" or "interstate" property. This is significant because when Congress wanted to make such distinctions in the Act it did so. See, *e.g.*, 47 U.S.C. 221(c) and (d), and 410(c). The fact that Congress did not make such a distinction here indicates that it intended no distinction.

17. Taken as a whole, the language of Section 220 appears clearly to preempt the states in connection with depreciation expense determinations and the related accounting. The language strongly implies that the states may not depart from depreciation rules prescribed by the FCC unless the Commission in its discretion allows them to do so. Otherwise, the federal statute would govern state depreciation practices in form only, allowing the states to treat substantive depreciation matters as they

might choose. While that might be a plausible construction of Section 220, after full analysis we do not believe that Congress intended such a feeble gesture. There would be little purpose to require the carriers to keep all their books pursuant to an FCC prescription, and then allow the states to require the carriers to follow inconsistent depreciation practices. Instead, the language of the section and the comprehensive treatment given to this matter by the Congress demonstrate that more was intended. Accordingly, we find that the statutory language indicates that FCC depreciation prescriptions are to be followed in both the federal and state jurisdictions unless the FCC provides otherwise. As demonstrated below, this construction is also consistent with the legislative history.

B. *Legislative History*

18. In the *Preemption Order* we found that the legislative history of Section 220 was inconclusive and at most indicated that Congress was "not sure" about the preemptive effect of the new legislation. 89 FCC 2d at 1106. However, the reconsideration petition and comments supporting it show that Congress believed that the language ultimately adopted would preempt the states from prescribing depreciation rates for subject carriers when the Commission had prescribed rates.

19. In our *Preemption Order,* we observed that Section 220 of the Communications Act had been adopted from Section 20 of the Interstate Commerce Act, and our review of the few ICC cases touching upon preemption did not reveal the ICC to have possessed the kind of broad preemptive power now urged by GTE and AT&T. However, after reviewing the pre-1934 cases again, we find that, while not dispositive, they lean more toward GTE and AT&T's views than against them.

20. The closest the ICC came to delineating its position on this matter came in *Depreciation Charges of Telephone Companies,* 118 I.C.C. 295, 332 (1926), where it said:

> It seems to be well established that where a local telephone company undertakes to originate or deliver toll messages, and most of them do so undertake, practically all of its property is open for use in interstate commerce and at any time may be so used. Under such circumstances, no doubt would seem to exist as to the power of Congress to regulate the accounting practices of such companies with respect to their property, including the accounting for depreciation.

In the *Preemption Order* we focused on the fact that the ICC had not actually prescribed depreciation rates and thus there was uncertainty regarding the ICC's actual authority. However, after reviewing that case again we find that the better and more sensible interpretation is that if the ICC had prescribed depreciation rates, the state commissions would have been precluded from prescribing rates that diverged from those it prescribed. We cited *Smith v. Illinois Bell Tel. Co.,* 282 U.S. 133, 159 (1930), in the *Preemption Order* as supporting our conclusion that the ICC decision did not preempt the states. In that decision the Supreme Court held that absent ICC action prescribing depreciation rates, Section 20(5) did not preclude states from prescribing depreciation rates. Since the ICC proceeding did not actually prescribe depreciation rates, but only began a proceeding looking toward the ultimate prescription of depreciation rates, there were no depreciation rates prescribed that could have preempted state-prescribed depreciation rates. Thus *Smith* only stands for the proposition that until the ICC actually prescribed rates, there was no basis for preempting the

states. It did not reach the question of whether Section 20(5) would preempt the states if the ICC prescribed depreciation rates.[3]

21. At the hearings pertaining to the Communications Act the then chairman of the ICC indicated his belief that the ICC depreciation rulings would govern both federal and state depreciation practices:

> Paragraph (j) . . . should be most carefully considered. It unquestionably directly conflicts with, and destroys the uniformity of systems of accounts and depreciation accounting required by the preceding provisions of the section. That is not true under the present law.[4]

22. Other witnesses who appeared at the hearings repeated the same view. See statements of Mr. Gifford,[5] Mr. Benton,[6] and Dr. Irvin Stewart.[7]

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[3]Similarly, *Interstate Commerce Commission v. Goodrich Transportation Co.*, 224 U.S. 194 (1912) and *Kansas City Southern Ry. Co. v. I.R.S.*, 52 F. 2d 372 (8th Cir. 1931) do not appear to have any pertinance to the issue at hand. As noted in 89 FCC 2d at 1099, *Goodrich* did not raise any question with respect to the effect of ICC accounting rules upon activities not subject to ICC rate regulation. The *Kansas* holding simply reconciles two federal statutes, the Internal Revenue Code and the Interstate Commerce Act. It did not purport to establish new law on state preemption.

[4]Ltr. of F. McManamy, Hearings on S. 2910, p. 208.

[5]Hearings on H.R. 8301, pp. 191-192 (See 89 FCC 2d at 1105, fn. 17). The *Preemption Order* had indicated that Mr. Gifford's preemption views were tentative. However, careful review of that testimony reveals that Mr. Gifford's uncertainty may have concerned the date Section 20(5) was enacted, not preemption.

[6]Hearings on S. 2910, 73rd Cong., 2d Sess., p. 181 (1943).

[7]Hearings on H.R. 8301, 73rd Cong., 2d Sess., p. 17 (1934).

23. The *Preemption Order* relied heavily on the "silence contained in the Congressional Reports," 89 FCC 2d 1105, in concluding that the legislative history did not support a finding that Section 220 was intended to preempt state commissions from prescribing their own depreciation rates for intrastate purposes. However, a reexamination of the legislative history in light of the comments on reconsideration indicates that the committee reports accompanying the bills did contain language indicating that the committees believed that the predecessor provision had preempted the states. The House Report, in discussing the Section 220(j) provision (which was not adopted) that would have reserved jurisdiction over depreciation rates to the states for purposes of intrastate ratemaking, stated that the provision was "responsive to the requests of the State commissions that the present law be *changed so as to permit* those bodies to exercise, for State purposes, certain jurisdiction over . . . depreciation accounting."[8]

24. In remarks on the House floor, Representative Rayburn, Chairman, House Committee on Interstate and Foreign Commerce explained Section 220 of the proposed bill as follows:

> [p]aragraphs (a) to (g), relating to accounts records, memoranda, and depreciation, is based upon sections

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[8]H.R. Rep. No. 1850, 73rd Cong., 2d Sess. 7 (1934) (emphasis added). The section (j) proposed by the House would have provided: "Nothing in this section shall (1) limit the power of a State commission to prescribe, for the purposes of the exercise of its jurisdiction with respect to any carrier the percentage rate of depreciation to be charged to any class of property of such carrier, or the composite depreciation rate, for the purpose of determining charges, accounts, records, or practices; (2) relieve any carrier from keeping any accounts, records, or memoranda which may be required to be kept by any State commission in pursuance of authority granted under State Law." H.R. 8301, 73rd Cong., 2d Sess. Section 220(i) (February 27, 1934).

20(5) to (8) of the Interstate Commerce Act with *changes necessary to permit State commissions to prescribe* the systems of accounts for the intrastate operation of carriers. Paragraphs (h) to (j) are new . . . *paragraph (j) removes any limitation upon the power of a State commission to prescribe, for the purposes of the exercise of its jurisdiction, rates of depreciation.* The last three paragraphs named were placed in the bill at the request of the State commissions which feel that their task of regulating intrastate communications will be greatly facilitated by the adoption of these paragraphs.[9]

25. The Senate version of Subsection (j) took a totally different approach than the House version. It called "for investigation and report to Congress instead of immediately turning over these matters to the State." S. Rep. No. 781, 73rd Cong., 2d Sess. 5 (1934).[10] The version of Section 220(j) finally enacted was the result of agreement in the conference committee. The conferees agreed to adopt the House provisions as to Sections 220(h) and (i), but decided against the House Section 220(j), proposal to remove any limitation upon the power of states to prescribe rates of depreciation. Instead, Section 220(j) was modified

[9]78 Cong. Rec. 10314 (1934) (emphasis added).

[10]The Senate version of Section 220(j) provided: "The Commission shall investigate and report to the Congress whether in its opinion legislation is desirable (1) authorizing the Commission to except the carriers of any particular class or classes in any State from any of the requirements under this section in cases where such carriers are subject to State commission regulation with respect to matters to which this section relates; and (2) permitting the State commissions, in pursuance of authority granted under State Law, to prescribe their own percentages rates of depreciation or systems of accounts records, or memoranda to be kept by carriers." S. 3285, 73rd Cong., 2d Sess. Section 220(j) (March 23, 1934).

along the lines of the Senate proposal to require the Commission to "investigate and report to Congress as to the need for legislation to define or further harmonize the powers of the Commission and of State commissions with respect to other matters to which this section relates." Conf. Comm. Rep. No. 1918, 73rd Cong. 2d Sess. 17 (1934). The obvious inference to be drawn is that the conferees were not prepared at that time to allow the states to prescribe depreciation rates different than those established at the federal level, but that matter might be considered later if the report required by Section 220(j) indicated it to be appropriate.

26. The hearing testimony and Committee reports therefore indicate that the language being recodified from Section 20(5) of the Interstate Commerce Act preempted the state commissions' jurisdiction over depreciation. The rules of statutory construction provide that where Congress reenacts a provision from an existing statute, it intends that the construction applicable to the existing provision apply as well to the new provision.[11] The legislative history thus supports the actual language of Section 220(b) and indicates that Congress intended to preempt state commission jurisdiction over depreciation rates for subject carriers when it recodified the language from the Interstate Commerce Act. Accordingly, we conclude that the analysis of the legislative history contained in the comments of AT&T and GTE accurately represents the intent of Congress and that the more persuasive reading of the legislative history supports the construction that Section 220(b) preempts inconsistent state action where the Commission has prescribed depreciation rates for a carrier.

[11]Courts have given weight to interpretations of the Interstate Commerce Act in interpreting the Communications Act. See, *e.g.*, *American Telephone and Telegraph Company v. FCC*, 487 F.2d 865 (2d Cir. 1973).

C. *Administrative and Court Decisions*

27. The *Preemption Order* cited *Accounting Rules for Telephone Companies,* 203 ICC 13 (1934), as evidence that the FCC could not preempt state depreciation practices. There the ICC recognized that states might have additional accounting needs and indicated that it had permitted state-prescribed sub-accounts within the federally-required books of account. However, the adoption of a blanket subdivision rule does not lead to the conclusion that federally adopted accounting and depreciation rules are not preemptive. Rather, it reflects an awareness that state commissions may have special data requirements to properly administer their regulatory policies which may require additional detail beyond that prescribed by the federal agency. A subdivision rule, however, does not permit what is accounted for as an expense to be capitalized in the guise of subdividing an expense account. While we may allow subdivisions of accounts, we will not allow inconsistent accounting or depreciation methods unless such practices are otherwise consistent with the public interest. Any other policy would obliterate the prescriptive effect of our adoption of a uniform system of accounts.

28. In fact we have approved variations from the prescribed uniform system of accounts. For example, our rules give carriers blanket authority to subdivide certain prescribed accounts "provided such subdivisions do not impair the integrity of the accounts prescribed." 47 C.F.R. 31.01-2(d)(1). C.F. 31.01-2(f), authorizing carriers to subdivide accounts "in the manner ordered by any state commission having jurisdiction. . . ." We also have approved state commission rate making treatment of plant under construction different from that adopted by us. See 89 FCC 2d at 1107.

29. There may well have been some instances of inconsistent state treatment of depreciation in the past. However, we do not seek controversy unless it is necessary to protect vital federal interests. Either such instances did not come to our attention or they may not have appeared threatening to federal interests.[11] In the past the communications marketplace was typified by monopoly conditions and life and salvage factors underlying the state rates were generally very similar, if not identical, to those used by the Commission. In that environment, it was not essential that the Commission assert all the authority granted it. See *Computer and Communications Industry Association v. FCC,* No. 80-1471 (D.C. Cir. November 12, 1982). As discussed, *infra.,* in the more competitive conditions prevailing today, the utilization of proper methods and rates is more critical if the proper incentives are to be created to insure that the marketplace will function efficiently to bring the benefits of that competition to the ratepayers of this country. Therefore, where it is necessary to protect important federal policies against frustration by inconsistent state actions, we will exercise the full breadth of our depreciation powers. *See* para. 14 above.

30. Nor is there any merit to the argument that federal preemption of depreciation practices constitutes intrastate ratemaking which might run afoul of 47 U.S.C. 152(b). Section 220(b) only prohibits the states from setting depreciation rates for telephone property inconsistent from those prescribed by the FCC. It does not require that any particular tariff for intrastate service be accepted by the state commissions. The setting of depreciation rates and classes

[11] *Pacific Telephone and Telegraph Company v. California,* 401 P.2d 353 (1965), was cited in the *Preemption Order* to support non-preemption. However, the California Supreme Court did not analyze Section 220(b) or its legislative history and its determination is therefore unpersuasive.

of depreciable property only resolves a single issue impacting the ratemaking process. It does not restrict the state commission's broad discretion in setting charges for individual services. In any event, Section 2(b) of the Act, 47 U.S.C. 152(b), has a well defined purpose which would not be implicated here: "to restrain the Commission from interfering with those essentially local incidents and practices of common carriage by wire that do not substantially encroach upon the administration and development of the interstate telephone network." *NCUC I, supra* at 794 n.6. Here the setting of depreciation rates is not an essentially local incident or practice and it has substantial effects upon the administration and development of the interstate telephone network.[13]

D. *Preemption Under Federal Supremacy*

31. Even if one were to assume that Section 220(b) did not automatically preempt the states whenever this Commission has acted, federal preemption of inconsistent state depreciation would be justified in this case to avoid frustration of validly adopted federal policies. The Fourth Circuit has stated:

> We have no doubt that the provisions of section 2(b) deprive the Commission of regularly power over local services, facilities and disputes that in their nature and effect are separable from and do not substantially affect the conduct or development of interstate communications. But beyond that, we are not persuaded that section 2(b) sanctions any state regulation, formally restrictive only of intrastate communication, that in effect encroaches substantially upon the Commission's authority under sections 201 through 205.

NCUC I, supra at 793. To the same effect, see *Computer and Communications Industry Association v. FCC, supra* at 35.

32. The D.C. Circuit recently addressed the preemption question, observing:

> We fail to see any distinction in this case between preemption principles applicable to state ratemaking authority and those applicable to other state powers. The operative principle [is that] . . . preemption of state tariffs on CPE is justified because state tariffs would interfere with the consumer's right to purchase CPE separately from transmission service and would thus frustrate the validly adopted federal policy.

Id. at 38. The court went on to find that conflicting state regulation may be preempted even though there is some indirect effect on state ratemaking discretion, noting:

> the Act itself does not distinguish between authority over rates and authority over other aspects of communications. Sections 2(a) and (b) of the Act allocate federal and state authority with regard to both "charges [and] . . . facilities." Therefore, conflicting federal and state regulations regarding dual use CPE are no more acceptable under the Act when equipment rates are involved, as here, than when interconnection policies are involved, as in the *NCUC* cases.

Id. at 38-39.

33. The provision for adequate capital recovery is important to "make available, so far as possible, to all

[13] Nor is federal preemption of depreciation practices inconsistent with 47 U.S.C. 221(b). Section 221(b) was intended to reserve state jurisdiction over exchange rates where exchange boundaries extend over two states. That provision was not intended to create new reservations to the states beyond that contained in Section 2(b) and the narrow circumstances encompassed by interstate exchanges. See *Computer and Communications Industry Association v. FCC, supra*, and *North Carolina Utilities Commission v. FCC*, 552 F.2d 1036, 1046 (4th Cir. 1976), *cert. denied*, 434 U.S. 874 (1977) (hereinafter cited as *NCUC II*).

the people of the United States a rapid, efficient, Nationwide, world-wide wire and radio communication service with adequate facilities at reasonable charges . . . ." 47 U.S.C. 151. State depreciation rate prescriptions that do not adequately provide for capital recovery in the competitive environment, which constitutes this Commission's policy in those markets found capable of supporting competition, would frustrate the accomplishment of that policy and are preemptable by this Commission.

34. Over the past decade the Commission has embarked in several areas of telecommunications to pursue a policy of encouraging competition wherever the market conditions will support such a policy and produce benefits to the public interest. In *MTS-WATS Market Structure Inquiry,* 81 FCC 2d 177 (1980), the Commission opened the domestic MTS-WATS market to competitive entry, reserving the question of entry to Alaska to a later phase since concluded with the adoption of a similar open entry policy, *MTS-WATS Market Structure Inquiry,* FCC 82-515 (released November 30, 1982). In *Computer Inquiry II,* 77 FCC 2d 384 (1980), *recon.,* 84 FCC 2d 50 (1980), *recon.,* 88 FCC 2d 512, *aff'd sub nom., Computer and Communications Industry Association v. FCC, supra,* the Commission opened the areas of enhanced services and customer premises equipment to competitive provision. These are just two examples of the policies which the Commission has pursued. However, they do point up the fact that if this policy is to be successful, it will be necessary for the marketplace to operate efficiently. Such efficient operation requires proper price signals generating from supply and demand conditions.

35. Capital recovery is an important determinant of the price at which services can be offered and significantly affects the amount of facilities provided to supply the

needs of the communications industry. In *Amendment to Part 31,* 83 FCC 2d 267 (1980), *recon.,* 87 FCC 2d 916 (1981), the Commission adopted remaining life and straight line equal life group depreciation methods that recover capital on a basis that approximates straight line unit depreciation more closely than did the previously used methods. More timely capital recovery was anticipated to result in faster technological innovation with its accompanying benefits of more efficient service provision and lower costs resulting from more productive use of facilities.

36. Capital recovery issues are important in the implementation of *Computer Inquiry II* due to the part depreciation plays in the determination of net book value and the resultant gain or loss that may occur on the transfer of assets to the new subsidiary. It will also be significant in any later transfer of assets from the provision of regulated service to unregulated service or vice-versa. Thus, appropriate capital recovery will ease the regulatory burdens associated with supervising the transition to the new structure.

37. Depreciation is a significant portion of the revenue requirement of the regulated telephone companies. As such, it plays an important role in determining the price at which they offer their services. If competition is to be viable, it is necessary for prices to reflect depreciation expenses that are realistic for a competitive market. Absent such depreciation levels, improper signals will be given to the market. Since most plant is used interchangeably to provide interstate and intrastate communications service, supply and demand is determined by the combination of inputs from service demand in both regulatory jurisdictions. Approximately 75 percent of exchange plant is allocated to the intrastate jurisdiction. It is clear that unless telephone plant, including that portion subject to allocation to the intrastate jurisdiction, is

depreciated at a reasonable rate, improperly timed capital recovery will occur. Indeed, in an increasingly competitive environment, it is possible that improper capital recovery could delay or prevent modernization which would add to the costs borne by ratepayers and could, ultimately, threaten carriers' ability to fully recover their invested capital. Moreover, the extent of state action attempting to prevent carriers from utilizing our depreciation prescriptions places substantial burdens on carriers and could well impair their ability to raise the investment capital they will need to fully compete in the continually evolving competitive telecommunications marketplace.[14] Such a result could undermine the achievement of the Commission's objective to develop policies that will engender a dynamic, efficient telecommunications marketplace with services being provided at reasonable prices.

38. NARUC contends that preemption with respect to station connections is unnecessary and will not produce competitive benefits because expensing is not the same as unbundling. While NARUC is correct in a strict sense, it avoids the critical issue, which is the proper timing of cost recovery. If the Commission preempts with respect to station connections and all states must expense these costs, current ratepayers will be paying these costs instead of future ratepayers as would be the case with capitalization. Thus, future prices will reflect the appropriate costs for providing those services. Moreover, if these costs are expensed and state commissions must allow rates to cover these costs, it is likely that the cost causative ratepayer will in many cases be charged for the costs being expensed in connection with the provision of inside wiring. Thus, the Commission's objective may be substantially achieved by preempting state commissions from departing from our expensing rules.

39. In 1971 Congress amended the Communications Act to change the procedures for allocating costs between federal and state jurisdictions by adding Section 410(c). The Commission was given the ultimate authority with respect to such allocations, further solidifying its superintendency over common carrier communications. See *NCUC I, supra* at 795. Section 410(c) procedures provide for uniformity in the separations process, thereby insuring that plant, expenses and revenues will be rationally accounted for in the dual jurisdictional environment. The utilization of one depreciation rate is the most effective method for insuring that this uniformity will be maintained and to insure that no jurisdiction bears a greater burden than another in the transition to a fully competitive marketplace. Several parties suggest that under or over recovery will result from one jurisdiction or another because of the shifting usage patterns for telephone plant over time and argue that if such a result were to occur, significant inequities would result to both ratepayers and carriers. A uniform depreciation rate for each class of property applicable to all property whether allocated to the federal or state jurisdiction clearly eliminates these potential problems.

40. For all of these reasons, it is apparent to us that a substantial impact on federal policies could result if state commissions were allowed to diverge from Commission prescribed depreciation rates and practices. Accordingly,

[14]AT&T and GTE indicate several state commissions have refused to follow, have indicated an intent not to follow, or are being urged not to follow Commission determinations with respect to the expensing of inside wiring and/or the adoption of straight-line equal life group or remaining life depreciation methods. A staff review of state action in conjunction with AT&T intrastate tariff proceedings reveals that all but two states have approved expensing of station connections, that 13 states have rejected and 12 have approved equal life group depreciation, and that 9 states have rejected and 22 have approved remaining life group depreciation. Prior to issuing our *Order* in this docket we did not expect that such significant variance would be required by states.

it is essential to preempt inconsistent state depreciation practices to avoid frustration of these vital national policies.

III. *Declaratory Ruling Petition.*

41. GTE of Ohio seeks to have the Commission preempt an order of the Ohio Public Utilities Commission that did not approve remaining life and equal life group rates for intrastate ratemaking purposes. As alleged by GTE of Ohio, the differential in rates amounts to seven million dollars per year. GTE of Ohio states that failure of this Commission to preempt the state will frustrate the achievement of federal policies adopted by this Commission. Its argument is similar to those cited in connection with the reconsideration petition.

42. Essentially the same arguments are made against the GTE of Ohio petition as were urged on reconsideration with regard to the substance of the issue. However, Ohio cites an Ohio statute that precludes the state commission from adopting remaining life depreciation for intrastate purposes.

43. One procedural argument is raised by Ohio with respect to the petition. It contends that the question presented is premature since the order is subject to further reconsideration before the Ohio Commission pursuant to a request filed by GTE of Ohio. We do not agree since the purpose of declaratory rulings is to give guidance to affected persons in areas where uncertainty or confusion exists. A case or controversy in the judicial sense is not required, *NCUC I, supra* at 790-1. In this case, it appears necessary to issue such a ruling to clarify for the state commissions and the carriers the effect of our depreciation prescriptions. The fact that reconsideration proceedings are under way in Ohio does not mitigate against such a course in light of the divergencies from this Commission's depreciation methods and rates that are occurring to the detriment of federal policies. Thus, we find it imperative

to declare today that inconsistent state prescribed depreciation rates are preempted by the Communications Act and are accordingly void. The existence of a state statute preventing a state commission from adopting a particular method does not affect this determination. When federal preemption is involved, there is no difference between a statute or a regulation of a state commission. Both must fall in the face of overriding federal concerns and policies.

IV. *Conclusion*

44. We have carefully reviewed the record upon reconsideration. The issues raised concerning the *Preemption Order* caused us to reevaluate the statutory language of Section 220(b), the legislative history of the provision, and the relevant judicial and administrative proceedings relating to the subject. Our considered judgment after this review is that the *Preemption Order* must be reconsidered. We find that the most logical and reasonable interpretation of Section 220(b) of the Act is that where the Commission prescribes depreciation rates for classes of property, state commissions are precluded from departing from those rates. Since the depreciation method utilized is a material part in determining the rate to be applied, state commissions are also precluded from departing from the depreciation methods prescribed by the Commission. Thus, the *Expensing Order* is binding upon state commissions and they must expense additions to inside wiring in accordance with the plan established therein. Moreover, they must follow the amortization procedures adopted in that decision for the embedded inside wiring and any additions to the capitalized amount as a result of the phase-in of the expensing of inside wiring.

45. Even if Section 220(b) does not preempt state commissions, we would act under our authority to preempt state actions that interfere with the accomplishment of federal policies and objectives. *Computer and Communications Industry Association v. FCC, supra,* and *NCUC II.*

We note that petitioner and the parties supporting the petition cite several states that have indicated they do not intend to follow the Commission's depreciation prescriptions or expensing of inside wiring, or have refused to follow either. In light of the concerns expressed about an efficiently functioning market, we must find that inconsistent depreciation rates prescribed by state commissions will interfere with the efficient operation of the communications marketplace and thereby frustrate the achievement of the Commission's policies. Accordingly, we find that this Commission's depreciation policies and rates, including the expensing of inside wiring, preempt inconsistent state depreciation policies and rates.

46. Accordingly, IT IS ORDERED, pursuant to Sections 1, 4(i), and 220(b) of the Communications Act of 1934, as amended, 47 U.S.C. 151, 154(i), and 220(b), That the Petition for Reconsideration filed by the American Telephone and Telegraph Company IS GRANTED.

47. IT IS FURTHER ORDERED, That the Petition for Declaratory Ruling filed by General Telephone Company of Ohio IS GRANTED to the extent reflected herein.

48. IT IS FURTHER ORDERED, That the Secretary shall cause this order to be published in the Federal Register.

49. IT IS FURTHER ORDERED, That the Secretary shall cause a copy of this order to be served on each state commission.

FEDERAL
COMMUNICATIONS
COMMISSION*

William J. Tricarico
Secretary

See attached separate statement of Commissioner Joseph R. Fogarty.

Appendix A. Summary of Comments

1. AT&T argues that the Commission on reconsideration should find that state commissions are precluded from departing from the depreciation methods and rates established by this Commission in order to allow the carriers to achieve timely capital recovery. It views the *Preemption Order* as a retreat from the Commission's competitive policies.

2. AT&T asserts that realistic depreciation rates are essential to attain accurate cost-based pricing decisions to prevent artificial barriers to competition, to foster technological innovation which will enhance network efficiency and the availability of competitive alternatives, to facilitate the timely implementation of the detariffing of customer premises equipment[1] and to insure the financial viability of the carriers. It contends that competitive conditions result in faster obsolescence and shorter asset lives, requiring that depreciation methods and rates be inseparable from ratemaking to insure capital recovery.

3. AT&T proposed two legal theories for preempting state commission action. First, it asserts that the Commission may preempt under Sections 1 and 2 of the Act, citing *California v. FCC,* 567 F.2d 84, 86 (D.C. Cir. 1977), *cert. denied,* 434 U.S. 1010 (1978), *NCUC II, NCUC I,* and *NARUC v. FCC,* 533 F.2d 601 (D.C. Cir. 1976). It states that because of the central role depreciation, including the depreciation aspects of station connections, plays in the achievement of the Commission's policies, preemption is necessary to avoid interference with or frustration of these policies.

[1]It contends that different depreciation rates between jurisdictions will result in disagreements about net book value in deregulating CPE and that the application of the Separations Manual will create uncertainty as to which plant a particular book value relates.

4. AT&T's second theory is that Section 220(b) preempts states on its face, asserting that in its earlier pleadings it did not rely on Section 220(g) as suggested by the Commission's decision. It argues that Section 220 gives the Commission discretion with respect to accounting rules, but does not give it much discretion with regard to depreciation prescriptions. AT&T states that the Commission's rule allowing carriers to subdivide an account to comply with a state commission order does not mean that a state can require capitalization when this Commission requires expensing. Finally, it submits that the Commission misread the legislative history of the Communications Act by failing to consider statements in the committee reports and remarks of members at committee hearings that indicate Congress believed the Interstate Commerce Act provisions from which Section 220(b) was taken did in fact preempt the states. See also *Depreciation Charges of Telephone Companies,* 118 I.C.C. 295 (1926).

5. GTE asserts that the Commission's policies in the areas of competition and faster capital recovery will be frustrated if the state commissions are allowed to depart from the depreciation rates and methods prescribed by the Commission. It contends that Section 220(b) preempts the states and distinguishes Section 220(a) as being discretionary on the Commission and argues that the Commission focused only on the provisions of Section 220(a) in its earlier decision. It submits that there is no doubt that a state can require a carrier to keep additional records and memoranda. However, GTE argues that the Commission's decision is overly broad. It is clear, GTE contends, that the Commission can preempt inconsistent state action when it conflicts with national telecommunications policies, and it should do so in this case. GTE also argues that the legislative history and the rules of statutory construction indicate that Congress intended to preempt the states in the

area of depreciation, submitting that property cannot be successfully depreciated at two different rates prescribed by different regulatory bodies because under or over recovery from one or the other jurisdiction will occur from the use of shifting usage factors.

6. The oppositions generally argue that the states have the jurisdiction to determine the extent to which intrastate rates reflect depreciation and expensing adjustments promulgated by the Commission. Sections 2(b) and 221(b) are cited as reserving jurisdiction over local and intrastate telephone rates to the states as intended by Congress when it distinguished between "interstate" and "intrastate" in Sections 1 and 2. Ohio argues that the preemption argument was rejected in the only case of which it is aware, *Pacific Telephone and Telegraph Company v. California,* 401 P. 2d 353 (1965).

7. Ohio asserts that the courts have distinguished between ratemaking and interconnection policies, *NCUC II* and *NCUC I,* and submits that it is the ratemaking jurisdiction reserved to the states that is in question in this proceeding. To permit the Commission to prescribe depreciation rates applicable to all property whether used for interstate or intrastate services would, in Ohio's view, be equivalent to giving the FCC a hand in setting state rates.

8. Ohio is concerned that under some methods, such as remaining life, costs will not be charged to consumers who receive the benefits of the property being depreciated. Finally, it contends that Sections 220(i) and (j) are consistent with concurrent jurisdiction.

9. Ohio argues that GTE is attempting to have the Commission read Section 2(b) out of the act, and asserts that it is inappropriate to ignore language in a statute, to extend a statute beyond its clear import, or to embrace subjects not specifically enumerated. Section 2(b)(1) is stated

by Ohio to have been intended to reverse the Supreme Court decision in *Houston East and West Texas Ry. v. U.S.*, 234 U.S. 342 (1914), wherein the ICC was given the power to suspend intrastate rates enabling carriers to raise intrastate rates to federal levels for similar distances. NARUC and Ohio argue that Section 2(b) was intended to ensure that state jurisdiction was not limited by the 1934 legislation.

10. Several parties assert that there is considerable Commission precedent recognizing the states' independent ratemaking authority, including departures from Commission prescribed accounting, for intrastate rates. They note that the Commission has encouraged state commissions to devote more resources to depreciation matters, *Amendment of Part 31,* 83 FCC 2d 267 (1980) *recon.*, 87 FCC 2d 916 (1981), has recognized in this proceeding the state jurisdiction over expensing of station connections for state ratemaking purposes, has recognized divergent treatment of interest during construction and has not contested California's use of remaining life for approximately thirty years. Ohio argues that there is nothing to suggest that there needs to be national uniformity in depreciation procedures and that local diversity is desirable, noting that even a GTE of Ohio witness in an Ohio rate case has indicated that local diversity in setting depreciation rates is preferable.

11. Ohio contends that *McDonnell Douglas Corp. v. General Telephone Company of California*, 594 F.2d 720 (9th Cir. 1979), recognized the validity of intrastate regulatory jurisdiction under the Act by finding that Congress in enacting Section 2(b) had intended to give states considerable power with respect to wire communications that are wholly intrastate in nature.

12. California argues that the Commission's refusal to preempt state power to prescribe depreciation rates for

intrastate ratemaking purposes will not undermine the Commission's procompetitive policies or signal a retreat since many states have adopted policies that foster competition. AT&T's assertion that preemption must be exercised to promote procompetitive policies is rejected by NARUC as unsupported. It states that expensing of station connection costs can have no competitive effect because expensing is not the same as unbundling. Moreover, it contends that the Commission did not adopt remaining life and equal life group depreciation procedures to promote competition but, rather, to more properly time capital recovery and insure that any deficiency in past depreciation was adjusted. Finally, NARUC states that the speculative statements about the numbers of states that are not following the Commission's policies are inadequate to justify preempting state commission jurisdiction on the theory that federal policies are being frustrated.

13. NARUC argues that the attempted distinction of Section 220(a) from Section 220(b) on the basis that Section 220(b) is mandatory while Section 220(a) is discretionary does not address the question of the preemptive effect of either section. It contends that neither reason nor case law provides support for asserting that preemption of state regulation of intrastate communications is automatic with respect to subject areas which the FCC must regulate on the interstate level. It further notes that the language of Section 220(b) does not differ significantly from that in Section 220(g) with respect to the effect of prescribed depreciation rates, accounts or records other than as prescribed by the Commission. NARUC states that the relationship between accounting and ratemaking is self evident and argues that state control over intrastate rates would have little vitality if state com-

missions were deprived of the power to disallow expenses and depreciation claimed by carriers. NARUC asserts that the fact that a proposed Section 220(j) that would have expressly reserved depreciation prescription powers to the states was not adopted does not mean that states must be bound by Commission depreciation prescriptions, stating that the final provision adopted was a compromise.

14. Consumers' Counsel supports the Commission's *Preemption Order* and generally cites from that *Order* in support of its position. Idaho also agrees with the conclusion of the Order and states that it believes that administrative costs of separate record keeping to meet state requirements will be small. Arkansas filed to indicate that its opinions had not rejected the new depreciation methods outright but had left the decision to individual cases for resolution.

15. AT&T's reply submits that the setting of depreciation rates does not constitute the exercise of jurisdiction with respect to charges for intrastate services. It argues that Section 2(b) does not deprive this Commission of jurisdiction over jointly used property where its regulation affects the conduct or development of interstate communications. AT&T states that if a state utilized the depreciation rate prescribed by the Commission, it may make adjustments to the test period data to reflect concepts of used and useful property or other pro forma adjustments to reflect conditions during the period during which the tariff will be in effect.

16. AT&T distinguishes *Houston East and West Texas Ry. Co. v. U.S., supra,* by asserting that that case involved actual preemption of service rates. It notes that while Congress may have sought to reverse that decision in the communications field, the issue here is only the jurisdiction

to prescribe depreciation rates. Thus, it contends that the case actually suggests that Section 2(b) should be narrowly interpreted. Moreover, while use of federally prescribed depreciation rates may significantly affect intrastate rates, the states remain free to price individual service rates. See *e.g., NCUC I.*

17. USITA submits that federal preemption of jurisdiction over depreciation rate prescriptions for carriers for which the Commission has prescribed depreciation rates would not interfere with state commission ability to set intrastate service rates in accordance with any ratemaking method desired. It contends that the setting of depreciation rates is not a ratemaking function pursuant to Sections 201-205, but is the exercise of a specific power granted to the Commission by Congress. USITA argues that divergent depreciation rates create confusion and raise problems of capital recovery.

18. GTE contends that state action whether in the nature of ratemaking or otherwise which "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress" will be preempted. *Fidelity Federal Savings and Loan Association v. de la Cuesta,* 50 LW 4916, 4919 (1982). GTE concludes that the states do not have the power through the guise of ratemaking to negate FCC action designed to give effect to federal statutory objectives. GTE does not challenge state rights pursuant to state statutes to regulate rates for intrastate services. It asserts that no preclusion of state ratemaking jurisdiction would result from FCC preemption under Section 220(b), although failure to preempt will endanger important national policies.

19. GTE submits that Section 220(b) charges the Commission with the responsibility of prescribing depreciation rates for carriers subject to the Act and recognizes only two exceptions. First, the Commission should act as

soon as possible. Second, Section 220(h) recognizes that certain classes of carriers may be exempted. The Commission, according to GTE, has not exercised its authority pursuant to this provision in this proceeding. Finally, GTE argues that reliance on *NCUC I* and *NCUC II* as supporting a finding that the Commission cannot preempt state commission depreciation prescriptions for carriers subject to the Act is inconsistent with the holdings and analysis of those cases. AT&T and GTE submit that Section 221(b) is inapplicable because that provision was intended only to give states the jurisdiction to regulate local exchange service extending over a state boundary.

Separate Statement of
Commissioner Joseph R. Fogarty

In Re: Reconsideration of Docket No. CC 79-105.

Having dissented from the Commission's original decision declining to preempt State accounting and depreciation rules inconsistent with those prescribed by the FCC,[1] I am pleased that the Commission has reconsidered this issue and acted to preempt such inconsistent State regulation.

As this *Order* establishes in detail, a true reading of the statutory language and legislative history of Section 220(b) of the Communications Act clearly demonstrates that Congress intended FCC depreciation rules and policies to control the field.

Even if preemption were not explicitly mandated by Section 220(b), the effective implementation of our pro-competitive federal telecommunications policies dictates that inconsistent State depreciation regulation be preempted by this Commission. We cannot "defer to the States" on capital recovery issues. Telephone companies must be able to recover their cost of capital in a timely and effective manner if they are to price their services efficiently and to improve and expand their facilities to meet the challenges of competition and technologic innovation.

This preemption imperative is not merely theoretical. Too many States (e.g., Alabama, Louisiana, Nebraska, Ohio, New Jersey, Michigan, Arkansas) have already refused to recognize the critical necessity of the FCC's cost recovery principles. The resulting depreciation rate differentials are alarming: GTE of Ohio has indicated that it

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[1]Amendment of Part 31, Joint Dissenting Statement of Commissioners Joseph R. Fogarty and Anne P. Jones, 89 FCC 2d 1109-1111 (1981).

will be denied $7 million in capital recovery this year if the State of Ohio's disparate depreciation treatment is allowed to prevail.

The FCC cannot ignore the detrimental impacts of inconsistent State treatment of depreciation if our pro-competitive policies are to have any integrity and viability. This Commission now recognizes that preemption is both mandated as a matter of law and essential as a matter of policy, and our action today has my full endorsement and support.

Appendix B

Communications Act of 1934, as amended

47 U.S.C. § 151

SEC. 1. For the purpose of regulating interstate and foreign commerce in communication by wire and radio so as to make available, so far as possible, to all the people of the United States a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges, for the purpose of the national defense, for the purpose of promoting safety of life and property through the use of wire and radio communication,[1] and for the purpose of securing a more effective execution of this policy by centralizing authority heretofore granted by law to several agencies and by granting additional authority with respect to interstate and foreign commerce in wire and radio communication, there is hereby created a commission to be known as the "Federal Communications Commission," which shall be constituted as hereinafter provided, and which shall execute and enforce the provisions of this Act.

47 U.S.C. § 152

SEC. 2. (a) The provisions of this Act shall apply to all interstate and foreign communication by wire or radio and all interstate and foreign transmission of energy by radio, which originates and/or is received within the United States, and to all persons engaged within the United States in such communication or such transmission of energy by radio, and to the licensing and regulating of all radio stations as hereinafter provided; but it shall not apply to persons engaged in wire or radio communication or transmission in the Canal Zone, or to wire or radio

[1]The provisions relating to the promotion of safety of life and property was added by "An Act to amend the Communications Act of 1934, etc." Public No. 97, 75th Congress, approved and effective May 20, 1937, 50 Stat. 189.

communication or transmission wholly within the Canal Zone.[2]

(b)[3] Except as provided in section 224 and subject to the provisions of section 301, nothing in this Act shall be construed to apply or to give the Commission jurisdiction with respect to (1) charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service by wire or radio of any carrier, or (2) any carrier engaged in interstate or foreign communication solely through physical connection with the facilities of another carrier not directly or indirectly controlling or controlled by, or under direct or indirect common control with such carrier, or (3) any carrier engaged in interstate or foreign communication solely through connection by radio, or by wire and radio, with facilities, located in an adjoining State or in Canada or Mexico (where they adjoin the State in which the carrier is doing business), of another carrier not directly or indirectly controlling or controlled by, or under direct or indirect control with such carrier, or (4) any carrier to which clause (2) or clause (3) would be applicable except for furnishing interstate mobile radio communication service or radio communication service to mobile stations on land vehicles in Canada or Mexico; except that sections 201 through 205 of this Act, both inclusive, shall, except as otherwise provided therein, apply to carriers described in clauses (2), (3), and (4).

[2]The words "the Philippine Islands or" preceding "the Canal Zone" are omitted on authority of Proc. No. 2695, effective July 4, 1946, 11 Fed. Reg. 7517, 60 Stat. 1352, recognizing the independence of the Philippine Islands.

[3]Subsection 2(b) was amended by adding the words, "Except as provided in section 224 and" at the beginning of the subsection by section 5, Public Law 95-234, approved February 21, 1978, 92 Stat. 33. The subsection was previously amended to read as above by Public Law 345, 83d Congress, 2d Session, approved April 27, 1954, 68 Stat. 63. This subsection formerly read as follows:

(b) Subject to the provisions of section 301, nothing in this Act shall be construed to apply or to give the Commission jurisdiction with respect to (1) charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service of any carrier, or (2) any carrier engaged in interstate or foreign communications solely through physical connection with the facilities of another carrier not directly or indirectly controlling or controlled by, or under direct or indirect common control with such carrier; except that sections 201 to 205 of this Act, both inclusive, shall, except as otherwise provided therein, apply to carriers described in clause (2).

47 U.S.C. § 221

(b) Subject to the provisions of section 301 of this title, nothing in this chapter shall be construed to apply, or to give the Commission jurisdiction, with respect to charges, classifications, practices, services, facilities, or regulations for or in connection with wire, mobile, or point-to-point radio telephone exchange service, or any combination thereof, even though a portion of such exchange service constitutes interstate or foreign communication, in any case where such matters are subject to regulation by a State commission or by local governmental authority.